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No. 21795

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ESTATE OF EUGENE L. FREELAND, Deceased, by SECURITY FIRST NATIONAL BANK, a national banking association, Executor, and VERA GOOD FREELAND, by L. N. TURRENTINE, Conservator,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' OPENING BRIEF.

GEORGE T. ALTMAN,
424 South Beverly Drive,
Beverly Hills, Calif. 90212,

FRANK KOCKRITZ,
JAMES W. ARCHER,
GRAY, CARY, AMES & FRYE,
14th Floor, Bank of America Bldg.,
San Diego, Calif. 92101,
Attorneys for Petitioners.

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Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' OPENING BRIEF.

Jurisdiction.

This is an appeal from a decision of the Tax Court of the United States. The taxes involved are income taxes, and the taxable years involved are 1956 through 1961, inclusive. The decision of the Tax Court (Doc. No. 5181-64 in that Court) was entered December 30, 1966, and the petition for review thereof by this Court was filed and served March 24, 1967. [Tax Court General Docket, p. 3.] Jurisdiction is asserted under I.R.C. 1954, Sections 7482, 7483.

Statement.

The controversy involves the proper determination of the liability of Eugene L. Freeland and his wife, Vera Good Freeland, for Federal income taxes for the

calender years 1956 through 1961. They filed joint returns for those years. Mr. Freeland, hereinafter referred to as "Freeland," died December 3, 1966.

There is a single issue, whether the gain derived by Freeland from the sale by him on November 26, 1956, of his interest in a partnership, Sam Berger Investment Company, hereinafter referred to as "the partnership," was capital gain or ordinary income. The presence of the same issue in the several years involved herein results from the fact that Freeland reported that gain on the intallment basis.

The sole asset of the partnership upon the sale by Freeland of his partnership interest was a parcel of raw, unsubdivided land, 4200 acres in extent, located in San Diego County, California. Because of the provisions of Section 741 of the Internal Revenue Code of 1954, the gain by Freeland on the said sale of his partnership interest was capital gain unless the said parcel of land was then held by the partnership, within the meaning of Section 1221(1) of that Code, for sale to customers in the ordinary course of its trade or business. The facts relevant to a determination of whether the land was then so held are as follows:

From 1923 and up to the time of his death Freeland was a full-time civil and structural engineer living and working in San Diego County, California. He was licensed to practice by California and certain other states. During the years involved herein he was a senior member of a civil engineering firm and a structural engineering firm. [TC 3.]¹ His reputation was excellent. [TC 4.]

¹The reference is to pages in the "Memorandum Findings of Fact and Opinion" of the Tax Court contained in the record.

In 1953 Freeland was asked by one of his land developer clients, Kensington Heights Company, to help find a buyer for a parcel of raw, unsubdivided land in San Diego County known as the "Waring Ranch" property. That property had originally consisted of 6200 acres. In 1951 400 acres were annexed to the City of San Diego and subsequently sold by Kensington. An additional 1300 acres were annexed in 1952 or 1953 and sold by Kensington to Bollenbacher & Kelton, Inc., subdividers and developers. [TC 4.] In 1953 Kensington undertook to have the remaining 4500 acres annexed. Those remaining 4500 acres contained a lake, some canyons, and a mountain rising 1100 feet above the surrounding terrain. In connection with the proceeding for annexation, Freeland's civil engineering firm prepared a master plan map of the area, which indicated the lines along which development might feasibly proceed. The City annexed the 4500 acres in December, 1953. It was that area for which Kensington, shortly before the annexation, sought Freeland's help in finding a buyer. [TC 5.]

For this purpose Freeland contacted several of his land-developer clients, including one Carlos Tavares, hereinafter referred to as "Tavares," but they were not interested because they thought that development and subdivision of the area was too remote in time. [TC 5, 18; Tavares dep. pp. 4-5.] San Diego County was growing rapidly, however, and that growth was resulting in a continuing and substantial appreciation in real estate values. [TC 3-4.] In August, 1954, Freeland joined with another of his clients, one Sam Berger, hereinafter referred to as "Berger," in the acquisition

of the land. [TC 5.] For that purpose they formed the partnership above named, Sam Berger Investment Company.² [TC 5, 11.]

The purchase price was \$4,676,666.66, \$100,000.00 down and the balance in 20 annual installments. [TC 6.] Partial releases from the trust deed were provided for, 150 acres against each annual installment paid. [TC 6.] The partnership was also required, under a provision inserted in the purchase agreement by Kensington, to deposit \$200,000.00 in escrow to be disbursed for off-site improvements upon instructions from Kensington. [TC 6, 26.] Such improvements include (a) bringing utilities up to the property, and (b) installing on the property, if it is in the path of future development, utilities large enough to meet the needs not only of the property on which installed, but also those of such future development. In approving a proposal for such improvements the City considers the development in terms of overall plans for the surrounding area. [TC 15.] The cost of such improvements in excess of that required by the property on which installed is generally paid by the City. [TC 6-7.]

Of the down payment of \$100,000.00 Freeland provided \$70,000.00, and Berger \$30,000.00. [TC 7.] The \$200,000.00 deposit also required by Kensington, for off-site improvements, the partnership obtained, after several unsuccessful efforts to obtain it from other sources [TC 8], from a joint venture of corporations engaged in land development known as "County Club Park." As consideration therefor the partnership gave

²The partnership is referred to in the findings and opinion of the Tax Court as "SBIC." [TC 9.]

(a) to two investors in that joint venture, Jack Barenfeld and Samuel Glaser, a 20% interest in the partnership [TC 8, 11]; and (b) to a newly created and wholly owned subsidiary of that joint venture, Lake Murray Development Company, a corporation, hereinafter referred to as "Lake Murray,"³ an option to buy, at \$2,000.00 per acre, 500 acres out of an 800-acre portion of the 4500 acres being purchased from Kensington. [TC 8-9.] As the partnership was now divided, Free-land held 32% as general partner; a designee of his, Margaret C. Lowthian, 8% as limited partner; Berger 20% as general partner; two designees of his, being a trust for each of his two sons, as limited partners, 10% each; and Barenfeld and Glaser, under the name of "Lake Murray Trust No. 1," as limited partners, the remaining 20%. [TC 11.]

Under the option agreement so created between the partnership and Lake Murray, the partnership agreed to reimburse Lake Murray for expenses in excess of a stipulated maximum per lot cost of development, any saving below such cost belonging as profit to the partnership; and the partnership also agreed to be liable for all off-site improvement costs in excess of the \$200,000.00 deposited in escrow for that purpose. [TC 10.] The partnership's purchase escrow closed October 26, 1954. [TC 9.] On November 4, 1954, Lake Murray exercised its option to the extent of 3.19 acres for the purpose of building model homes, and proceeded to make the aforesaid off-site improvements. [TC 14.]

The off-site improvements were made to the 500 acres subject to Lake Murray's option. [TC 16; testimony

³Referred to in the Tax Court's findings as "LMDC." [TC 8.]

of Eugene Francis Cook, Tr. 294-295.] The principal aim in construction of these facilities was to provide adequate facilities for the 500 acres with minimum damage to the remaining 4000 acres. [TC 16.] Although the total deposit required by Kensington was only \$200,000.00, the average cost of off-site improvements is \$1,000.00 per acre. [Tavares dep. pp. 16-17.]

Berger was the initial president of Lake Murray. [TC 8.] Freeland, however, had no interest in that corporation as either investor, director or officer. [TC 9.] He only rendered to it his consulting services as land engineer, for which it was agreed he would receive, in addition to any other engineering fees, \$25.00 per lot on the first 2000 lots. [TC 13.] The 500 acres were estimated to produce 2200 to 2400 lots. [TC 15.] The agreement to pay Freeland an engineering fee of \$25.00 per lot on the first 2000 lots was contained in the partnership's partnership agreement, which was reduced to writing as a formal limited partnership agreement on November 23, 1954, and to which Lake Murray was not a party. [TC 10, 13; Exs. 15, 18.]

Early in 1955 differences arose between the partnership and Lake Murray. [TC 16.] On February 3, 1955, the partnership, by Freeland, and Freeland individually, filed formal notices of non-responsibility for costs being incurred on the property by Lake Murray. [Stipulation, par. 19, Exs. 24, 25.] As of July 1, 1955, the option agreement between the partnership and Lake Murray was radically amended. The price per acre after the first 250 acres was cut to \$1,800.00. [Ex. 27, par. 2.] The fee of \$25.00 per lot to Freeland, previously payable by the partnership under its partnership agreement, was now made payable under the amended

option agreement by Lake Murray. [Ex. 27, par. 18.] More importantly, the lot and off-site improvement cost guarantees by the partnership contained in the original agreement were eliminated [TC 17], and the partnership was agreed not to be liable on any bond for the development of either on-site or off-site work relating to the development of the 500 acres. [Ex. 27, par. 11.] The entire scheme of liability and gain of the partnership in connection with the activities of Lake Murray was eliminated. [Ex. 27.]

Immediately thereafter, in July and August of 1955, Lake Murray further exercised its option to the extent of 146.93 acres, and commenced development of its first regular unit of homes. [TC 16.] By the summer of 1955, however, Lake Murray also developed financial difficulties. An attempt by Berger to obtain more saleable land by substitution of land in the foothills of the mountains failed because the cost of off-site improvements there would have been prohibitive. [TC 17.] Lake Murray was not able to overcome its difficulties. On May 4, 1956, it became insolvent. It then assigned to Phoenix Insurance Company of Hartford all of its assets except its remaining option to the extent of 200 acres. [TC 17.]⁴ The assets assigned thus included the option to the extent of 150 acres, and this Phoenix exercised on August 6, 1956. [TC 18; Stipulation, par. 27.] On August 10, 1956, Berger, because he himself, individually, was in financial difficulties, sold the 40% interest in the partnership held

⁴Lake Murray, thereafter assigned that retained interest in the option to certain of the investors in the said "Country Club Park" joint venture in consideration of the cancellation of claims for advances. See Findings 42(a) in the decision in *Morse v. United States*, referred to below at p. 10.

by himself and his two trusts to a new group headed by Tavares. [TC 18.] Tavares then approached Freeland, offering to take him into his group. Freeland refused that offer. [TC 18.] Tavares also tried to buy Freeland's interest but had difficulty even in getting a price. [Tavares dep., pp. 10-12.] Finally Freeland sold his 32% interest, which had cost him \$70,000.00, to the Tavares group, on November 26, 1956, for \$730,000.00. At the same time Margaret C. Lowthian sold her 8% interest to the Tavares group. [TC 18.]

The partnership never held any other land. [TC. 20.] It never advertised, promoted, or otherwise engaged in active efforts to solicit buyers for, or developers of, its land, either directly or through agents. [TC 19.] Freeland, on behalf of the partnership, refused several unsolicited offers to purchase portions of the acreage not covered by the Lake Murray option. [TC 19]. The partnership's only land transactions were those it was required to carry out, specifically the sales to Lake Murray under its option, a sale of a fractional acre to the telephone company, a sale of four acres to the City for a reservoir site as required by Kensington when the partnership purchased the land, and a grant of options for school sites to the San Diego School District pursuant to the conditions of the annexation. [TC 20.] Freeland individually never, at any time material, was a dealer in real estate or held any land for sale to customers in the ordinary course of his trade or business. [TC 19.]

San Diego County entered into a period of substantial population growth after World War II. [Stipulation, par. 3, p. 3.] As already noted above, it experienced rapid growth prior to and during the years here

in question. [TC 3-4.] In the decade 1930-1940 the population of the County increased 38%; in the decade 1940-1950 the increase, over 1940, was 93%; and in the decade 1950-1960 the increase, over 1950, was 86%. (California Statistical Abstract, p. 11, Table B-5.) As to the City itself, the corresponding percentages were 37, 64 and 71. (Statistical Abstract of the United States, 1950, p. 59, 1966, p. 21.) This growth of San Diego resulted, as also noted above, in a continuing and substantial appreciation in real estate values. [TC 4.] Tavares, the largest developer in the area [Tavares dep., pp. 12-13]. built six or seven thousand homes during 1954-1956 [*Ibid.* p. 7], and sold as many lots in one year to different builders. [*Ibid.* p. 13.] During that period also, the firm of Bollenbacher & Kelton, which, as noted above, had acquired 1300 acres of the Waring Ranch property in 1952 or 1953, was doing quite well. [*Ibid.* p. 7.] In 1954 the 4500 acres of that property then being acquired by the partnership was fairly worth seven to eight hundred dollars per acre for eventual development [*Ibid.* pp. 18-19], and that figure, or even a thousand dollars per acre, was a good price for investment. [*Ibid.* p. 21.] The proof of the actual appreciation in value of that property during 1954-1956 was what Tavares paid for it. [*Ibid.* p. 14.]

Freeland reported his gain on his sale to the Tavares group as capital gain, on the installment basis. [TC 20.] The Commissioner examined his return for 1956, specifically questioned his treatment of the gain as capital gain, and examined the books and records of the partnership as well as many official City records. Thereafter, on September 19, 1958, the Commissioner, by

notice to Freeland, upheld the latter's treatment of the gain as capital gain. Almost four years later, however, on April 26, 1962, the Commissioner reopened that examination, and, by the statutory deficiency notices involved herein, on July 29, 1964, determined that the gain was ordinary income. This determination the Commissioner followed for subsequent years. The Tax Court sustained the Commissioner's determination that the gain was ordinary income, not capital gain, and also his reopening of the examination for 1956. [TC 21.]

The said reopening by the Commissioner of his examination was done because of the large amount involved and "in the interest of being consistent" with the cases of other partners in the partnership, handled by another agent. [TC 21.] The latter cases wound up in a test case of one of the partners (a transferee of .723% out of the 20% of the said "Lake Murray Trust No. 1") in the United States Court of Claims, *Morse v. United States*, 371 F. 2d 474, decided January 20, 1967. We do not cite that case in the argument portion of this brief only because a motion for reconsideration filed by the government is pending there. It is very significant, however, that that motion was based solely on the decision of the Tax Court here, despite the fact that the reopening here was done for the purpose, the express purpose, of being consistent with the group of cases involved there.

As noted above, an additional reason given by the Commissioner for the reopening was the large amount of tax involved here. The total amount of the deficiencies asserted, without including interest, for the years 1956 through 1961, is \$239,469.78. [TC 2.] Accu-

mulated interest would add approximately \$126,500.00, so that the actual total would be more than \$365,000.00. This approximately equals the total assets in the decedent Freeland's estate, as shown by the total inventory filed in that estate.⁵

Specification of Errors.

1. The Tax Court erred (in its opinion, at p. 23) in finding that the plans of the Sam Berger Investment Company "at the time of acquisition of the property continued to govern its subsequent activities."

2. The Tax Court erred in holding that, at the time of the sale by Freeland of his partnership interest in Sam Berger Investment Company (November 26, 1956), the real property of said company was held by it for sale to customers in the ordinary course of its trade or business, within the meaning of I.R.C. 1954, Sec. 1221(1).

Summary of Argument.

The result here depends on the purpose for which the Sam Berger Investment Company, herein referred to, as above, as "the partnership," held its property, vacant land; and that purpose is to be determined as of the time when Freeland sold his interest in the partnership. The Tax Court determined that purpose to be sale to customers in the ordinary course of

⁵The docket number of the estate in San Diego is No. 84374. The statement above as to the condition of the estate is made on the basis of judicial notice. As to judicial notice of documents required by law to be filed in another court proceeding, see *Donnelly v. U.S.* (C.A. 9, 1953), 201 F. 2d 826, *Sternberg v. Moran* (C.A. 2, 1952), 196 F. 2d 1002, *Nongard v. Burlington County Bridge Commission* (C.A. 3, 1956), 229 F. 2d 622, *Martinson v. U.S.* (D. Minn., 3rd Div., 1958), 162 F. Supp. 305, and *U.S. Ex Rel. Peters v. Carson* (W.D. Pa., 1954), 126 F. Supp. 137.

trade or business. That court, however, conceding the absence, from the activities of the partnership, of the normal criteria supporting such a purpose, relied here instead on the activities of another entity, Lake Murray Development Company, herein referred to, as above, as "Lake Murray."

This reliance by the Tax Court is based on its position [TC 29-31] that the two entities, the partnership and Lake Murray, were "interlocking." This position, however, at best vague and speculative, fails because: (1) it is inconsistent with the Tax Court's own findings, especially as to the severe breach detailed in the statement above, which early occurred between the two entities and was never healed; (2) the statutory provision involved relates only to property *held* for sale, but the partnership here never made a single sale of property held by it which it at any time had a choice to make or not to make, nor did it ever attempt to make one; (3) if, in any case, the "interlocking" of the partnership and Lake Murray charged by the Tax Court existed to begin with, it soon terminated, and any purpose of the partnership inferable therefrom changed; for within three months after the acquisition of the property by the partnership there ensued between the two entities the breach above referred to which was never healed; as a result thereof the partnership completely disengaged itself from any liability for, or gain from, the activities of Lake Murray; and before the sale involved here by Freeland of his interest in the partnership Lake Murray had failed and gone completely out of existence; and (4) the gain of Freeland on that sale was due in fact to appreciation in value of the land, resulting from the rapid and accelerating growth of San Diego.

ARGUMENT.

I.

Neither the Tax Court's Own Findings, nor Anything in the Evidence, Gives Either Form or Substance to the Tax Court's Imputation of the Activities of Lake Murray Development Company to the Partnership, Sam Berger Investment Company.

The conclusion of the Tax Court here approving the Commissioner's determination of deficiencies results from its agreement with the Commissioner that the purpose for which the partnership, Sam Berger Investment Company, held its property, vacant land, was sale thereof to customers in the ordinary course of trade or business, and that that was the purpose for which the partnership held the property at the time when Freeland sold his interest in the partnership. The Tax Court concedes, however, the complete absence, at any time at all, from the activities of the partnership, of the "normal criteria" of such a purpose for holding property, such as advertising, solicitation, or any other efforts to sell, or actual sales which it had a choice to make or not to make. [TC 33.] It relies instead on imputation to the partnership of the activities of another entity, Lake Murray Development Company; and it concedes that if it did not rely on that imputation its conclusion would be different. [TC 32-33.]

How the Tax Court reaches such imputation is also significant. It makes no attempt to tie the two entities together by showing, which it could not, or even stating, that there was common control, as by the same persons controlling both entities, or one of the entities con-

trolling the other, as the taxpayers controlled the developing entity in *Ackerman v. U.S.* (C.A. 5, 1964), 335 F. 2d 521, and *Todd Tibballs v. U.S.* (Ct. Cls., 1966), 362 F. 2d 266. What the Tax Court relies on here to tie the two entities together is what it characterizes as “interlocking participations” between them [TC 29-30], the fact that they had certain “common participants” [TC 31], that the partners of the partnership “were deeply involved” in the activities of Lake Murray. [TC 33.]

What the Tax Court’s opinion attempts in this vague and speculative manner is to engraft upon its findings an assumption or gloss of common control, and this in conflict with those very findings. If the two entities were under such control, no clash between them could have occurred. As shown in the Statement above, on the basis of the findings and the stipulated exhibits, a breach between the two entities developed within three months after the agreement between them was signed. That agreement was not merely amended as a result to eliminate “disputes arising out of the working relationships” between the two entities, as the opinion of the Tax Court attempts to explain [TC 30]; the amendments completely disengaged the partnership from any responsibility for, or any gain from, the activities of Lake Murray. Thus any thesis of common control of Lake Murray and the partnership is wholly without substance, is on the contrary in conflict with the court’s own findings.

In the same connection the Tax Court finds suspicious the price of \$2,000.00 per acre charged Lake Murray, while the average price to the partnership was only \$1,037.00 per acre. [TC 30.] But as the Tax Court

found, the 4500 acres contained a lake, some canyons, and a mountain 1100 feet high. [TC 5.] The attempt by Berger to obtain substitution of land in the foothills of the mountain ran into the obstacle of prohibitive off-site improvement cost. Also, when a large tract is divided into lots or other pieces, the price per acre for a piece is higher than the price per acre of the entire tract. See *Todd Tibballs, supra*, at page 270. Obviously, then, the average price of the 4500 acres could hardly be a basis for a reasonable price per acre for the 500 acres. There is nothing then to support the Tax Court's vaguely and laboriously framed assumption of common control. It conflicts instead with the court's own findings.

Thus the Tax Court's attempt to tie the two entities together, by the "interlocking" relation upon which its imputation to the partnership of the activities of Lake Murray, by its own terms, depends, does not hold.

II.

The Statute Speaks Only of the Holding of Property for Sale to Customers; but as Shown by the Tax Court's Own Findings, the Partnership Never Made a Single Sale of Any Property Held by It in Respect to Which It at Any Time Had a Choice to Make the Sale or Not to Make It.

It is obvious that property is not held for sale to customers in the ordinary course of trade or business unless it is held for sale; and before it can be held by the taxpayer for sale it must in fact be *held* by the taxpayer, and the taxpayer must have a right to sell it, or not to sell it.

This certainly was not true of the 500 acres subject to Lake Murray's option. From the moment the partnership acquired the property it was subject to that option; and the partnership had to make it subject to that option in order to get the \$200,000.00 deposit required to complete the acquisition. Thus it had no choice but to make the sales to Lake Murray. As to the sales by the partnership out of property not subject to the option there was not a single one of which this was not also true—not a single one, not even one, the partnership was not required to make or could not have been required to make. Any offers by others were refused. There was no listing, no solicitation of purchasers, directly or indirectly. It follows that the Tax Court's conclusion was based only on representations of plans before the partnership acquired the property, and such representations by Lake Murray afterwards, none of which reached fruition. It was not based on any holding of the property—any kind, form, or manner of actual holding of the property—by the partnership.

But, again, the statutory provision involved speaks only of the *holding* of property for sale to customers in the ordinary course of trade or business. It does not speak of a dream of such holding before the property is actually held, and certainly not of such a dream which never reaches reality.

III.

The “Interlocking” Relation Between the Partnership and Lake Murray Upon Which the Tax Court Relies, Assuming It Had the Substance and Effect Which the Tax Court Attributes to It, Came to an End More Than a Year and a Half Before the Sale Involved Here by Freeland of His Interest in the Partnership.

The Tax Court, citing *Todd Tibballs v. U.S.*, *supra*, recognizes that a change of purpose can take place after acquisition. Assuming then that the partnership, after it acquired the property, had a purpose, which the Tax Court derives solely from the “interlocking” relation with Lake Murray [TC 29, 29-30, 32-33], to hold the property for sale to customers in the ordinary course of its trade or business, the question is whether that purpose still existed at the time Freeland sold his interest to the Tavares group.

In this connection it must be borne in mind that a parcel of land is not the same as an inventory of shirts or automobiles. It is normal to hold land for investment. A parcel of land may be held for investment even by a person in the real estate business. Indeed, a particular piece of real estate can even be held for investment by one holding other pieces of the same tract for sale to customers in the ordinary course of trade or business. *Todd Tibballs v. U.S.*, *supra*, at p. 271; *Scheuber v. Commissioner* (C.A. 7, 1967), 371 F. 2d 996. The reason is the propensity of land, because of increase or influx of population or enterprise, to

increase in value without any activity on the part of the holder. In this respect real estate has a very special character.

Now looking at the history of the property involved here we find that a radical change took place after the property was acquired. Early in 1955, within three months after the option agreement was executed between the partnership and Lake Murray, differences arose between them. The partnership, then guarantor of the off-site improvement costs incurred by Lake Murray, disputed the propriety of the work being done and filed notices of non-responsibility for such costs. By the middle of 1955, as observed under point 1 above, the agreement between them was amended so as to eliminate every aspect of responsibility and gain of the partnership in respect of the development work on the property. By that time also Lake Murray was in financial difficulties, from which it did not recover. By May, 1956, it had become insolvent and its activities came to an end.

Somewhat the same situation appears in *Todd Tibballs v. U.S.*, *supra*. There two brothers, sole owners of several development corporations, had acquired a tract previously subdivided into some 435½ lots. They submitted to the city a proposal for water, sewer and street improvements, which was approved. In 1951 they sold two lots to one of the development corporations; it built experimental houses on them. In 1952 they sold 100 lots to another of these corporations; that corporation proceeded to build houses on about 60 of the lots; then it sold the other 40 lots to other corporations, one controlled by them and two uncontrolled. Finally, in 1952, the brothers sold the remaining 333½ lots in

a single sale to an outside builder. As to the 102 lots the Court of Claims decided they were held by the brothers for sale to customers in the ordinary course of their trade or business; as to the 333½ lots it concluded that they were not so held and were therefore capital assets.

The court there found (p. 272) that the development activities, including the water, sewer and street improvements, had been narrowed down to the 102 lots, as here such improvements were limited to the 500 acres. The court there also found (p. 270), as to the other 333½ lots, that, as here in the case of the 4000 acres not subject to Lake Murray's option, there were no signs or listings and they had refused offers for the individual lots. The court there also found (pp. 270, 272), as here, that the portion of the tract developed was not doing well, and that there was no further development activity. From this the court there (p. 272) inferred that if the brothers there had originally intended to develop or retail all of their 435½ lots they had given up that intention and had contented themselves with the 102 lots previously sold by them. The court there then observed (p. 273) that a taxpayer's purpose can change, and it is his purpose "during the period prior to the sale which is critical." The court by inference from the circumstances above stated concluded that the purpose had indeed changed, that it had become "the realization of appreciation in value accrued over a substantial period of time," as quoted from *Commissioner v. Gillette Motor Transportation, Inc.*, 364 U.S. 130, 134, 86 S. Ct. 1497, 1500, rather than profits "arising from the everyday operation of a business," as quoted from *Corn Products Refining Co. v. Commis-*

sioner, 350 U.S. 46, 52, 76 S. Ct. 20, 24. The Court of Claims therefore, as above noted, allowed capital gain on the 333½ lots.

The situation here, indeed, is even clearer. Here the property-owning entity had no such control as there of the development entity. The Tax Court here relied upon "interlocking" of the entities, based upon, not actual control of the one entity by the other, or actual common control of both entities, but only certain "common participants," however they participated, and this in the face of a bitter breach never healed between the two entities. Here also the development entity failed altogether and the "interlocking" of the two entities, such as it was, and it is entirely upon that that the Tax Court here relied, came to an end. Actually it came to an end in February, 1955, when the notices of non-responsibility were filed; certainly at least by July, 1955, when the amended agreement was executed. Of course, by no means could it be said to exist after Lake Murray's activities came to an end, in May, 1956. To say that no change occurred would be to deny the Tax Court's own findings. Following *Todd Tibballs v. U.S.*, *supra*, it is clear here, assuming the partnership was ever tainted by Lake Murray's purposes, and, if it was, assuming further that that taint had any substance beyond the 500 acres subject to Lake Murray's option, assuming both of those necessary elements, the taint was completely washed out by the early rupture between the two entities, and not even the imagination could conjure it up after Lake Murray's activities had come to an end.

IV.

The Gain of Freeland on the Sale by Him of His Partnership Interest Was in Fact Due to the Appreciation in Value, of the Land Held by It, as a Result of the Rapid and Accelerating Growth of San Diego.

It is said that the proof of the pudding is in the eating. The findings show clearly as the cause of the gain involved here, the rapid, accelerating growth of San Diego and the resultant appreciation in its real estate values. During the very years involved here some 1300 adjoining acres being developed by other builders were done well. And we have here the testimony of the largest developer in the area, and the one who purchased the property, that the proof of the appreciation in value was what he paid for it. Thus the gain was due in its entirety to appreciation, and that is exactly what the capital gain rates are for. *Commissioner v. Gillette Motor Transportation, Inc., supra*; *Todd Tibballs v. U.S., supra*.

Conclusion.

Petitioners submit in conclusion that the decision of the Tax Court herein should be reversed.

Respectfully submitted,

GEORGE T. ALTMAN,

Attorney for Petitioners.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

GEORGE T. ALTMAN

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

ESTATE OF EUGENE L. FREELAND, Deceased, by
SECURITY FIRST NATIONAL BANK, a national
banking association, Executor, and VERA
GOOD FREELAND, by L. N. TURRENTINE,
Conservator,

Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE
TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

FILED

NOV 27 1967

WM. B. LUCK, CLERK

MITCHELL ROGOVIN,
Assistant Attorney General.

LEE A. JACKSON,
DAVID O. WALTER,
MARCO S. SONNENSCHN,
Attorneys,
Department of Justice,
Washington, D. C. 20530.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 21795

ESTATE OF EUGENE L. FREELAND, Deceased, by
SECURITY FIRST NATIONAL BANK, a national
banking association, Executor, and VERA
GOOD FREELAND, by L. N. TURRENTINE,
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v.

COMMISSIONER OF INTERNAL REVENUE,

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ON PETITION FOR REVIEW OF THE DECISION OF THE
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BRIEF FOR THE RESPONDENT

OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court
(I-R. 114-151), ^{1/} are not officially reported.

^{1/} "I-R." references are to Volume I of the record on appeal. "II-R."
references are to Volume II of the record on appeal.

JURISDICTION

The petition for review (I-R. 158-163) involves deficiencies in federal income tax for the taxable years 1956 to and including 1961 in the amount of \$239,469.78. On July 29, 1964, the Commissioner of Internal Revenue mailed to the taxpayers a notice of deficiency asserting deficiencies in tax for the years 1956 to and including 1961 totaling \$239,469.78. (I-R. 10-11.) Within ninety days thereafter, on October 19, 1964, the taxpayers filed a petition with the Tax Court for a redetermination of these deficiencies under the provisions of Section 6213 of the Internal Revenue Code of 1954. (I-R. 1-11.) The decision of the Tax Court was entered December 30, 1966. (I-R. 152.) The case is brought to this Court by a petition for review filed March 24, 1967 (I-R. 158-163), within the three-month period prescribed in Section 7483 of the Internal Revenue Code of 1954. Jurisdiction is conferred on this Court by Section 7482 of that Code.

QUESTION PRESENTED

Whether the Tax Court was correct in deciding that a partnership had been holding land for sale to customers in the ordinary course of its trade or business.

STATUTES INVOLVED

The pertinent provisions of the statutes involved are set out in Appendix, infra.

STATEMENT

The facts relevant to this appeal, as found by the Tax Court (I-R. 115-134), some of which were stipulated, are substantially as follows:

Eugene L. Freeland and Vera Good Freeland^{2/} are husband and wife. Margaret C. Lowthian is a single woman. Taxpayers reside in San Diego County, California, and they filed their respective tax returns for the years in question with the District Director of Internal Revenue at Los Angeles, California. (I-R. 115-116.)

From 1923 through the time of trial, taxpayer has been a full time civil and structural engineer living and working in San Diego County, California. He is licensed to practice by California and certain other states and has been and continues to be a member of numerous professional engineering associations and societies. During the years involved herein, he was a senior member of a civil engineering firm and a structural engineering firm. (I-R. 116.)

^{2/} The issues involved in this case all relate to transactions of Eugene L. Freeland, now deceased. His wife Vera is a party solely because joint returns were filed for the years in question. For convenience, all references will be to Eugene L. Freeland as the taxpayer.

Taxpayer's practice has included land surveying, the design of municipal improvements, the subdivision of land, and the design of buildings and structures. He rendered professional services in some of the larger real estate developments in the San Diego area and included among his clients some of the area's most active real estate subdividers and developers. Because of the rapid growth of San Diego County prior to and during the years in question, and because of his excellent reputation, taxpayer's practice has been financially successful. The growth of San Diego County has also resulted in a continuing and substantial appreciation in real estate values. (I-R. 116-117.)

Among the many land developers employing taxpayer and/or his civil engineering firm (hereafter referred to as the "engineering partnership") were George T. Forbes and Theodore M. Jacobs, doing business as Kensington Heights Company. In the late 1940's and again in 1951 and 1953, the engineering partnership rendered services to Kensington with respect to the so-called Waring Ranch property in the form of surveying the land, preparing boundary, topographical and master plan maps thereof, and representation before the City of San Diego Planning Commission and other city departments in its efforts to have the land annexed to the City of San Diego so as to make it more salable. Four hundred acres were annexed in 1951 and subsequently sold by Kensington. An additional 1,300 acres were annexed in 1952 or 1953 and sold by Kensington to Bollenbacher & Kelton, Inc.,

subdividers and developers. The engineering partnership was then employed by Bollenbacher & Kelton, Inc., to do the engineering work on the subdivision and development of the 1,300 acres. (I-R. 117.)

In 1953, efforts were made by Kensington to have the City of San Diego annex the remaining 4,500 acres. At the time of the annexation proceedings, the engineering partnership prepared a master plan map of the area, which indicated the lines along which development might feasibly proceed. The City of San Diego annexed the 4,500 acres in December of 1953. The 4,500 acres contained a lake, some canyons, and a mountain rising about 1,100 feet above the surrounding terrain. (I-R. 118.)

Shortly before the annexation, Kensington sought taxpayer's help in finding a buyer for the 4,500 acres. Taxpayer contacted several clients who were not interested because they thought that development and subdivision of the area was too remote in time. (I-R. 118.)

In April 1954, Kensington gave taxpayer a verbal option on the land. Taxpayer and one of his developer-clients, Sam Berger, decided to form a partnership to purchase the land. On August 6, 1954, they entered into an agreement to form the partnership, the terms of which were to be reduced to writing in the near future. Under the agreement, Berger was to enter into an escrow in his own name for the purchase of the land from Kensington. Before the close of the escrow, Berger was to nominate the partnership to take title to the land. (I-R. 118.)

Berger negotiated the terms for the purchase with Kensington. In the course of the discussions, Berger indicated that the whole

4,500 acres would be developed as soon as possible and that he had \$20,000,000 in financing available, which was not in fact the case. Berger also told Kensington that the purchase price would be paid off in about three years. (I-R. 118-119.)

On August 6, 1954, Berger entered into an escrow agreement with Kensington. The agreement provided for a total consideration of \$4,676,666.66 (computed on the basis of \$800 per acre plus interest at 3-1/3 percent), payable \$100,000 down and the balance in 20 annual installments. The purchase price was to be evidenced by an installment promissory note, the first installment of \$180,000 to become due on August 6, 1955, with the remaining installments due annually thereafter in increasing annual amounts of \$6,000 until the 19th installment in the amount of \$288,000. The 20th and final installment was to be the remaining balance of \$130,666.66. The escrow agreement contained provisions for the release of 150 acres against each annual payment, for the privilege of prepayments with appropriate adjustments for interest, and for the deposit by the purchaser of \$200,000 to be disbursed for off-site improvements upon instructions from Kensington. (I-R. 119.)

The term "off-site improvements" comprehended two things: (1) the bringing of utilities, viz., water, sewer, gas, electricity, and telephone, from a point distant from the boundaries of the property being developed up to the boundaries of such property; and (2) the installation of a utility, e.g., a water main, on the property being developed, which utility is larger than required to serve such

property but which is nevertheless required by the City of San Diego in order to be available to serve further outlying property in the path of future development. With regard to these latter "off-site improvements," the city generally paid the difference between what the property being developed required and what the city insisted upon for purposes of future property development. (I-R. 119-120.)

Taxpayer provided \$70,000 towards the \$100,000 down payment. Berger borrowed the other \$30,000 with taxpayer acting as guarantor of the loan. (I-R. 120.)

In the process of trying to raise the \$200,000 deposit, taxpayer contacted the General Petroleum Corporation, seeking a loan. As part of the attempt to borrow the funds, a letter was sent on September 14, 1954, over taxpayer's signature, but without identification as to the capacity in which he was signing, to General Petroleum Corporation's representative in San Diego. The letter proposed that the corporation lend the necessary funds in exchange for exclusive service station sites within the contemplated 4,500-acre development. The letter also stated that a master plan for the development of the entire 4,500 acres was being completed and that it was proposed to start immediately the development of approximately 2,000 homes. The letter further stated that it was anticipated that a minimum of 4,000 homes would be constructed and occupied within three years and that, after the points involving financing the off-site improvements, completing the master plan, and selecting the location of the first 2,000 homes had been settled, consideration would be given to the sale of acreage to

subdividers capable of proceeding with the development in a satisfactory fashion. After due consideration, General Petroleum declined to provide any funds. (I-R. 120-121.)

After several unsuccessful attempts to raise the \$200,000 from various other sources, Berger's associates in a development operation consisting of a joint venture of several corporations, known as "Country Club Park" (for which taxpayer individually acted as a consultant before various governmental agencies), agreed to put up the \$200,000 for the off-site improvements. In return, this group (hereafter referred to as the "Barenfeld-Glaser Group") received a 20 percent interest in the Berger-Freeland partnership. (I-R. 121.)

On October 21, 1954, the Lake Murray Development Company, a California corporation (hereinafter referred to as "LMDC"), was incorporated for the purpose of subdividing and developing land and constructing homes thereon. LMDC was capitalized with funds that were advanced by the Barenfeld-Glaser Group. The stock of LMDC was held by Herbert Glaser, an attorney, as trustee for the benefit of the corporations which comprised the Country Club Park joint venture. Berger was the initial president of LMDC and Herbert Glaser was its secretary and attorney. Neither taxpayer nor Lowthian was an officer, director, stockholder, or investor in LMDC. Other principals included Sam Glaser, the father of Herbert, and Jack Barenfeld. (I-R. 121-122.)

Shortly after October 21, 1954, but prior to October 26, 1954, Sam Glaser and Jack Barenfeld caused \$200,000 to be advanced by the Country Club Park joint venture to LMDC and thence from LMDC to the

Berger-Freeland partnership, Sam Berger Investment Company (hereinafter referred to as "SBIC"). On October 25, 1954, SBIC caused the \$200,000 to be deposited in the escrow covering the purchase of the 4,500 acres. On October 26, 1954, the escrow was closed and title in the land was vested in SBIC subject to a deed of trust for the unpaid purchase price. (I-R. 122.)

On or about October 26, 1954, SBIC and LMDC entered into an option agreement, which was subsequently reduced to writing and executed on November 23, 1954. Partial consideration for this option was the fact that Sam Glaser and Jack Barenfeld had caused LMDC to provide the \$200,000 to SBIC to enable it to close the escrow. The agreement gave LMDC an option to purchase 500 acres of land lying within a larger parcel of approximately 800 acres in the southeast corner of the property for a price of \$2,000 per acre. (I-R. 122.) The option agreement further provided in pertinent part (I-R. 122-123):

(a) That SBIC was to release from the Kensington escrow a minimum number of acres per year in order to prevent a lapse of its right to continue to release acreage.

(b) That if LMDC purchased less than 150 acres per year under its option, SBIC had the right to sell the unpurchased difference.

(c) That LMDC realized that SBIC had an oral arrangement with "other subdividers" to purchase portions of the 800-acre parcel within which the 500 acres subject to the option was encompassed.

(d) That SBIC would cooperate with LMDC in filing the necessary maps and in expeditiously completing the building lots.

(e) That LMDC would submit to SBIC all its contracts with subcontractors for all items of work as so to guarantee that the cost would not exceed a certain minimum.

(f) That LMDC should be reimbursed by SBIC for expenses in excess of the stipulated maximum per lot cost of development, and SBIC would retain, as profit, any funds remaining in the trust fund established for lot development.

(g) That SBIC would be liable for all off-site improvement costs in excess of the \$200,000 originally advanced by LMDC.

On November 23, 1954, the date on which the option agreement between SBIC and LMDC was signed, a formal limited partnership agreement was also executed by all of the general and limited partners in SBIC. This agreement was effective as of August 6, 1954. Under the terms of the agreement, taxpayer, with a 32 percent interest, and Berger, with a 20 percent interest, were the general partners. Margaret C. Lowthian, taxpayer's secretary and business associate, with an 8 percent interest, was taxpayer's designee and was a limited partner. The HAB Trust and the MLB Trust, each with a 10 percent interest, were Berger's designees and were limited partners. The final 20 percent was a limited partnership interest held under the name of Lake Murray Trust No. 1. The interests of the HAB Trust and the MLB Trust in SBIC were created by Sam Berger for his two sons, Harvey A. Berger and Marshall L. Berger. Sam Berger was the sole trustee of the HAB Trust and the MLB Trust. Neither the beneficiaries of these trusts, Harvey A. Berger and Marshall L. Berger, nor the

trusts themselves held any interest in LMDC. The 20 percent interest in SBIC, held under the name of Lake Murray Trust No. 1, was established for the benefit of Jack Barenfeld and Samuel Glaser. At a later date, Barenfeld and Glaser gave 10 percent of their interest in this trust to the other members of the Barenfeld-Glaser group. (I-R. 123-124.)

The preamble to the SBIC partnership agreement provided that the purpose of the partnership was to engage "in the business of buying, selling and developing land upon the real property commonly known as the Third Annexation of the Waring Property consisting of approximately four thousand five hundred (4500) acres of land in the City of San Diego, State of California." (I-R. 125.)

The body of the agreement provided, inter alia (I-R. 125-126):

(a) That the term of the partnership would be 10 years.

(b) That each partner, general or limited, was prohibited from selling, assigning, or transferring his interest in the partnership to any person other than another partner but that the agreement would subsequently be amended to resolve the question of the withdrawal or sale by the partners of a partnership interest.

(c) That taxpayer and Berger were to contribute \$70,000 and \$30,000, respectively, to the partnership but further that they could withdraw said sums from the first monies available to the partnership.

(d) The general business policy of said partnership in all questions relating to the management of its business should be determined by the mutual consent of the general partners.

(e) Both general partners were to have full management rights and control.

(f) Taxpayer was to receive an engineering fee of \$25 per lot (in addition to any other engineering fees) from the first 2,000 lots "developed or sold by the partnership to third parties."

(g) That in the event the general partners could not agree, the problem would be submitted to arbitration.

After the closing of the Kensington escrow on October 26, 1954, Berger was anxious to get LMDC activated. The engineering partnership and taxpayer, as consulting engineer for LMDC, commenced applying for the necessary permits and talking with various city departments in order to get necessary city approval. Taxpayer's engineering partnership was also employed by LMDC and performed various services for LMDC relating to on-site development and off-site improvements. (I-R. 126.)

On November 8, 1954, taxpayer forwarded to the San Diego Planning Commission on behalf of LMDC a "Tentative Map Unit No. 1 [Lake Park Development Property]." Unit No. 1 consisted of approximately 50 acres to be subdivided into approximately 260-280 lots. Submitted at the same time were ten copies of a master plan map for the entire 4,500 acres and ten copies of a master plan map of the 800 acres subject to LMDC's 500-acre option. The master plan map of the 4,500 acres was an identical copy of that prepared for Kensington and Mrs. Waring on October 23, 1953, except that a portion of the lower right-hand section of that map had been cut out and a new section representing Unit No. 1 inserted. The map for the 4,500 acres indicated tentative locations for schools, parks, and supermarkets

for the entire tract. It showed that, when fully developed, the 4,500 acres would yield an estimated 16,000 lots. As a result of discussions with representatives of SBIC and LMDC concerning approval of the subdivision plan, the representatives of the San Diego Planning Commission understood that Unit No. 1 was the first unit in a planned development that would ultimately total 4,500 acres. (I-R. 126-127.)

On November 4, 1954, LMDC purchased 3.19 acres by a partial exercise of its 500-acre option. LMDC then commenced construction of seven model homes on this acreage. It was necessary for LMDC to bring off-site improvements to the Lake Park Property's southeast border in order to develop this acreage. In late December 1954, the seven model homes were completed and opened to the public for inspection. The advertising campaign referred to a "City of Tomorrow" to be developed on the 4,500 acres. Taxpayer, though he was aware of such advertising, disapproved of it and so informed Berger. (I-R. 127.)

On December 14, 1954, the City Council, on the recommendation of the Planning Commission, gave preliminary approval to the subdivision plan for Unit No. 1. Prior to December 23, 1956, LMDC, through taxpayer, its agent, submitted to the City Planning Department a tentative subdivision map for Units Nos. 2 and 3. Prior to January 17, 1955, LMDC similarly submitted a tentative subdivision map for Units Nos. 4 and 5. The size of the lots ranged between one-fourth of an acre and one-fifth of an acre. It was anticipated that 500 acres would produce between 2,200 and 2,400 lots. Units

Nos. 1 through 5, if fully developed, would contain a total of approximately 3,000 lots and covered the 800-acre parcel on which IMDC had a 500-acre option. (I-R. 127-128.)

The city, in considering a tentative subdivision plan, was concerned, inter alia, with the location and adequacy of schools, parks, shopping centers, and off-site improvements, including adequate water supply. Though an immediate proposal might concern only a very small number of acres, the city considered the development in terms of overall plans for the surrounding area. The city would not permit wasteful duplication of facilities such as two small water reservoirs where one larger reservoir would be considerably more economical. (I-R. 128.)

Both Berger and taxpayer represented SBIC in negotiations with the San Diego Unified School District pertaining to the granting of options for school sites within Units 1 through 5. (I-R. 128.)

On March 8, 1955, SBIC, through a letter signed by Berger, offered the School District school sites at a price equal to \$2,000 per acre plus "the average off-site cost for the entire 4,500 acres of approximately \$200 per acre," plus the cost of on-site improvements. Additional land for park and recreational purposes was offered on the same terms. This offer was not accepted by the School District. On September 23, 1955, SBIC, through a letter signed by Berger, offered the School District, for \$1 each, options on school sites within Units 1 through 5 at \$1,900 per acre for usable land. SBIC also agreed to give the School District renewable options on specific

sites of land selected by the School District on the remaining areas to be developed by SBIC. (I-R. 128-129.)

On July 26, 1955, the San Diego City Council adopted the Final Subdivision Map of College Ranch Unit No. 1, which map was filed and recorded in the County Recorder's Office on July 27, 1955. In July and August of 1955, LMDC partially exercised its 500-acre option and purchased an additional 146.93 acres from SBIC. LMDC then commenced development of Unit No. 1. LMDC also commenced the off-site improvement work for the 500-acre development. The principal aim in construction of these facilities was to provide adequate facilities for the 500 acres with minimum damage to the remaining 4,000 acres. (I-R. 129.)

In December 1954 or January 1955, a series of disputes arose between SBIC and LMDC. As a result of these disputes, LMDC and SBIC entered into an amended option agreement covering the 500 acres. The purchase price of the land was changed to \$2,000 per acre for the first 250 acres and \$1,800 per acre for all additional acreage. The "loan" of \$200,000 by LMDC to SBIC was labelled a "credit," with LMDC entitled to recover any portion not used for off-site improvements, and no interest would be paid on the credit. LMDC's prior oral agreement to pay taxpayer \$25 per lot for his personal service and counsel was reduced to writing. The agreement also eliminated the lot and off-site improvement cost guarantees by SBIC. (I-R. 129-130.)

LMDC engaged in the construction of 196 homes. By the summer of 1955, LMDC developed financial difficulties. In an attempt to remedy the situation, Berger sought a change in the amended option

agreement permitting LMDC to acquire what he thought would be more salable land. He proposed to develop land in the foothills of the mountain which would have a view of the lake. Employees of the engineering partnership prepared a feasibility study of the proposal, the conclusion of which was that the cost of off-site improvements would be prohibitive at that time. (I-R. 130.)

Ultimately, LMDC was unable to overcome its financial difficulties. It became insolvent on May 4, 1956. LMDC assigned to Phoenix Insurance Company of Hartford all of its assets, except that it retained the right under the amended option agreement to purchase 200 acres of land out of the 500 acres originally covered by the option. Since LMDC had already exercised its option to the extent of approximately 150 acres, the portion of the option assigned to Phoenix only covered the right to purchase the remaining approximately 150 acres. Phoenix subsequently exercised this option. (I-R. 130-131.)

Berger was blamed for mismanagement of LMDC and was himself in financial difficulty. In August 1956, Carlos Tavares, representing a group of developers, including himself, approached Berger and offered to purchase his interest in SBIC. Tavares had been one of the developers approached by taxpayer at the time of the annexation of the 4,500 acres. (I-R. 131.)

On August 10, 1956, the Tavares group agreed to buy out Berger's interest and the respective 10 percent interests of the HAB Trust and the MLB Trust in SBIC for \$950,000. Berger did not get taxpayer's

consent for the sale of his interest in SBIC as required by the partnership agreement. (I-R. 131.)

Tavares then approached taxpayer in an effort to purchase his interest in SBIC or, in the alternative, to have taxpayer join the Tavares group in the development of the SBIC land. Taxpayer told Tavares he was not interested in joining in the development and decided to sell out. Taxpayer received \$730,000 for his interest. In the agreement of sale, they consented to the purchase from Berger. (I-R. 131.)

During the taxable periods portions of the acreage were utilized for grazing and the raising of barley. The partnership reported gross income from these sources in 1955 of \$10,467.99 against total expenses of \$27,609.92 (of which \$15,319.51 represented real estate taxes) and in 1956 of \$17,958.50 against total expenses of \$45,032.69 (of which real estate taxes represented \$15,619.01). (I-R. 132.)

Taxpayer did not wish directly to engage in subdividing and developing the land, either individually or through any other business form, because it would place him in competition with his clients and those of his engineering partnership and thus be financially injurious. (I-R. 132.)

At no time material hereto was taxpayer individually a dealer in real estate or individually holding real estate for sale to customers in the ordinary course of business. (I-R. 132.)

Although no improvements were made directly to the acreage not covered by the option to LMDC, the entire tract benefited from the off-site improvements made by LMDC. SBIC itself never directly advertised, promoted, or otherwise engaged in active efforts to solicit for its land, nor did it authorize anyone to undertake such activities directly on its behalf. (I-R. 132.)

Taxpayer, on behalf of SBIC, refused several unsolicited offers for the sale of portions of the acreage not covered by the LMDC option. (I-R. 132.)

SBIC never purchased any real property except the 4,500 acres here in issue. The only sales of real property ever made by SBIC, aside from the 300 acres acquired under the 500-acre option to LMDC, were (1) the sale of a fractional acre to the telephone company and (2) the sale of approximately four acres to the City of San Diego for a reservoir site as required by Kensington when SBIC purchased the land. The only other land transactions of SBIC involved the grant to the San Diego School District of options to purchase sites within the area to be developed by LMDC for three elementary schools and one junior high school. SBIC also agreed to grant further similar options to the School District when development proceeded beyond the initial 500 acres. At the time of the annexation of the 4,500 acres, the city had required the then owners to agree to sell school sites within the property, and Kensington passed this obligation along to SBIC. (I-R. 133.)

Taxpayer reported gain on his sale of his partnership interest in SBIC on the installment basis as long-term capital gain. (I-R. 133)

The tax as disclosed on taxpayer's 1956 return was \$59,582.95. The Deficiency for 1956 was \$93,332.32, the major portion of which represents the gain from the sale of taxpayer's partnership interest. (I-R. 133.)

The Tax Court found (I-R. 134) that SBIC held the land in question primarily for sale to customers in the ordinary course of its trade or business. 3/

SUMMARY OF ARGUMENT

Although the sale of a partnership interest at a profit will generally result in capital gains treatment, the Internal Revenue Code provides that if the gain is attributable, in whole or part, to substantially appreciated inventory, then to that extent, the gain will be taxed as ordinary income. The question here is whether the land held by a partnership constituted inventory. Taxpayer contends the land was an investment while the Commissioner contends that the land was primarily held for sale to customers in the ordinary course of the trade or business, i.e., inventory.

When the partnership acquired this undeveloped land, it told the seller that the purchase price would be paid off in 3 years. It appears that the partnership would have had to sell the land in order to meet the annual installments of the purchase price because it had no other resources with which to make such payments. The seller of

3/ Another issue before the Tax Court was whether the Commissioner had abused his discretion in reopening taxpayer's taxable year 1956, which had been previously audited and determining additional deficiencies for that year. The Tax Court held (I-R. 151) that the Commissioner had not abused his discretion. Insofar as taxpayer does not discuss this point in his brief, we assume that this point is conceded.

the land knew that the land would have to be improved before the land could be sold (the lack of improvements had caused the seller difficulty in selling the land) and presumably to insure that such improvements would be made, required that the partnership deposit \$200,000 in escrow for such purpose. However, taxpayer testified that the partnership could not have developed the land, for such activity would have put him into open competition with developers in the area who were clients of his engineering firm. To overcome this problem, a corporation was set up in which taxpayer was not a stockholder but was a consultant. With the exception of taxpayer and his secretary, all the effective interests in the partnership were held by persons directly involved in the corporation. By virtue of this interlocking relationship, the partnership could insure development, without revealing taxpayer's participation, and as development would have progressed, the partnership would have sold the land either to the corporation or to other developers. However, this plan never reached full maturity for after having made improvements to the land, constructing some model homes and advertising them for sale, the corporation became insolvent. Shortly thereafter, one of the two general partners sold his interest to a developer and then taxpayer sold his interest to the same developer at a gain.

Taxpayer's major contention is that relating the corporation's activities to that of the partnership's is not permitted because neither entity controlled the other. However, we submit that such argument lacks merit because it overlooks the realities of the situation. Contrary to taxpayer's contention, the facts readily reveal

the inter-working of the two organizations, with the common objective of having the tract developed and sold. The corporation supplied the \$200,000 for off-site improvements and in return, was given an option on 500 acres. The partnership guaranteed to pay all off-site costs in excess of \$200,000. Also, the partnership afterwards offered land to the school board in an apparent effort to enhance the value of the tract. Furthermore, the partnership had to have been assured that the corporation was going to exercise the option, for it, the partnership, was planning on using the proceeds of such a sale in order to meet the first 5 installments on the purchase price. Equally revealing is that the corporation, although only the owner of 500 acres, advertised its model homes as the forerunner of a City of Tomorrow to be built on the 500 acres. Obviously then, both the partnership and the corporation were involved in one project, namely, to have the entire tract developed and sold.

Taxpayer also contends that even if there was at one time a purpose to sell the land, such purpose changed. This argument--which is raised here for the first time--is predicated on the fact that the corporation became insolvent and went out of business. However, this fact hardly requires a conclusion, as taxpayer urges, that the partnership's purpose automatically changed; it simply means that the partnership's plans for developing the tract and selling the land would not be done with the aid of the corporation. Moreover, the record shows that shortly after the corporation's demise, 80% of the partnership was sold, an unlikely event if the partnership had decided, when the corporation became defunct, to hold the property for investment, i.e., a long period of time.

The question is one of fact and should be reversed only if clearly erroneous. Insofar as there is ample evidence to support the Tax Court's finding that the land was held primarily for sale to customers in the ordinary course of business, it should be affirmed.

ARGUMENT

THE TAX COURT WAS CORRECT IN DECIDING THAT A PARTNERSHIP HAD BEEN HOLDING LAND FOR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF ITS TRADE OR BUSINESS

A. Introduction

On November 26, 1956, taxpayer sold his partnership interest in SBIC. Normally, under the provisions of Section 741 of the Internal Revenue Code of 1954,^{4/} Appendix, infra, the gain on such a sale would be taxed as capital gain. However, Congress recognized that this provision could be employed by members of a partnership to convert ordinary income into capital gain. Thus, for example, if instead of selling the inventory directly, i.e., in the course of trade, which would result in the partners having ordinary income, the members sold their partnership interest, then under Section 741, the gain on the latter method would be taxed at the lower capital gains rates. To prevent such an abuse, Congress enacted Section 751, Appendix, infra. section provides that to the extent that the gain on the sale of the partnership interest is attributable to substantially appreciated inventory, then to that extent, the gain will be taxed as ordinary income. In the instant case, all the parties agree that under the formulas contained in Section 751(d)(1)(A) and (B), the land is substantially appreciated. However, the point in dispute is whether or not the land constituted inventory of the partnership. Inventory of

^{4/} All references are to the 1954 Code, unless otherwise stated.

defined (Section 751(d)(2)(a)) as property described in Section 1221(1), and when reference is made to this latter section, it becomes apparent that this case involves a question which has given rise to much litigation: namely, whether property was being held for sale to customers in the ordinary course of taxpayer's trade or business.

In the case at bar, the Tax Court found (I-R. 134) that the land held by SBIC was property held for sale to customers in the ordinary course of its trade or business, i.e., inventory for purposes of Section 751. This being a question of fact, the narrow issue on appeal is whether this finding was "clearly erroneous." Willingwood Corp. v. Commissioner, 190 F. 2d 263, 265 (C.A. 9th); Richards v. Commissioner, 81 F. 2d 369, 370 (C.A. 9th); Yara Engineering Corp. v. Commissioner, 344 F. 2d 113 (C.A. 3d); Broughton v. Commissioner, 333 F. 2d 492 (C.A. 6th); Coffey v. United States, 333 F. 2d 945 (C.A. 10th); Tidwell v. Commissioner, 298 F. 2d 864 (C.A. 4th). If not, then, in accordance with the usual standards of review, it is entitled to finality. Commissioner v. Duberstein, 363 U.S. 278.

B. The partnership acquired and held the land primarily for sale to customers in the ordinary course of its trade or business

In determining whether or not property was being primarily held for sale to customers in the course of business, each case must stand on its own facts. However, because of the elusive nature of the question, the courts have developed guidelines in attempting to answer this question. These guidelines include: solicitation, amount of sales, advertising, and length of time the property was held. Taxpayer contends (Br. 13) that all of these "normal criteria" are lacking here

the instant case. But this case is unlike the usual case in that here the land was never sold by partnership (with the exception of 500 acres), and, obviously, the guidelines would be of no assistance. Thus in the usual case, a taxpayer has or has not employed agents, advertised, subdivided, etc., in the course of selling his land. These facts (or lack of them) are then on the record and the trier of fact, by employing the guidelines, can conclude whether the property was simply an investment that was being realized (sold) or whether the property actually had been held for sale and sold to customers in the course of business. But as noted, here the partnership did not engage in direct sales efforts and thus, of course, all of the "normal criteria" would be lacking. However, merely because the facts here preclude the use of these guidelines does not mean that the question as to taxpayer's primary purpose cannot be determined or that the question must, as a matter of law, be resolved in taxpayer's favor; rather, taxpayer's primary purpose in holding the land is simply more difficult to determine. Accordingly, what was said at the outset, namely, that each case in this area rests on its own facts, has particular importance in the case at bar. We submit that when all the facts of this case are examined, it is clear that from beginning to end, the partnership's primary purpose in acquiring and holding this land was for sale to customers in the ordinary course of its business.

Prior to selling the land to SBIC, the then-owner, Kensington Heights Company, had, with taxpayer's assistance, made extensive effort to sell the raw acreage to subdividers and developers. These efforts proved fruitless, the reason being (in taxpayer's words) (II-R. 47):

Too far in the future. Wasn't ready for development. Market couldn't absorb--too expensive on account of the off-site work. In other words, there was too much other property as close or closer-in that was more economical to develop and adjacent to the utilities that would be just continuing on with their present development. They were not interested in developing a new area. (Emphasis supplied.)

Kensington, unable to sell the land, then offered it to taxpayer who, together with Berger, decided to form SBIC. Kensington's terms of purchase were rejected and SBIC submitted its plan for financing the purchase. (II-R. 50.) All the negotiations were conducted by Berger who indicated that the entire area would be developed as soon as possible and that the purchase price would be paid off in about three years. (I-R. 118-119.) Because it had been unable to sell the land to developers because of the lack of off-site improvements and because, as will be discussed below, the financing arrangement had to be predicated on development, it appears that Kensington wanted to ensure that development of the area would in fact take place for it, Kensington, inserted in the purchase agreement a requirement that SBIC would deposit \$200,000 in escrow for off-site improvements. As the Tax Court observed (I-R. 139) "This is a peculiar requirement for a seller to impose in a mere sale of acreage. Granted that such sum would not cover off-site improvements for the entire 4,500-acre tract, the imposition of such requirement mirrors the vision of development which the parties, including SBIC, had in mind."

As mentioned above, Kensington, by inserting the \$200,000 deposit requirement, was attempting to insure that development would take place. It appears that the reason for Kensington wanting development was that its financing arrangement with SBIC clearly was predicated on the assumption that the purchase price would come from the proceeds of a development. Thus the total consideration was \$4,676,666.66 (including interest), with \$100,000 down and 20 annual installments. The first installment of \$180,000 was to be paid one year after the purchase and each of the remaining installments would be increased by \$6,000 until the 19th payment of \$288,000. The 20th installment would be in the amount of the balance, \$130,666.66. (I-R. 119.) It was contemplated that the proceeds from the sale of 500 acres to LMDC would pay the first 5 installments. This would mean that approximately \$3,500,000 still remained to be paid from that point on. Taxpayer's response as to how this large balance was to be paid was (II-R. 73) that there were no definite plans as to how this would be done but it would be taken care of when the need arose. ^{5/}

The Tax Court rejected

^{5/} Actually taxpayer suggested that, assuming the land increased, SBIC could borrow against the land. We submit that this is completely unlikely for even if the land did increase, it would be already burdened with a \$3,500,000 deed of trust and it is difficult to envision who would lend money against such collateral. Moreover, even if other loans could have been obtained, where was the capital to come from to pay this added indebtedness?

As for taxpayer's other possible source of funds, i.e., contributions from the partners, this is extremely doubtful. Berger had been able to raise no more than \$30,000 of his \$100,000 share for the down payment and taxpayer had to guarantee Berger's loan of \$30,000. Thus he hardly could be relied upon to contribute anything substantial towards a \$3,500,000 debt. Furthermore, although some of the partners were wealthy men, to raise the \$3,500,000 would have meant that they would have had to liquidate all their other assets, including business interests, and devote all of the capital to a tract of undeveloped land. This too, we submit, is hardly a likely assumption on which to contract a \$3,500,000 debt; especially when there was no agreement by

this highly unlikely arrangement, concluding instead (I-R. 139):

The lower payments in the earlier years seem to us more likely to reflect the understanding of the parties that development would be the generating source of the funds rather than, as petitioner suggests, the desire of SBIC to hold down the amounts required to be paid until it had had an opportunity to realize on the anticipated appreciation in value.

Moreover, in an attempt to raise the \$200,000 deposit, a letter was sent to General Petroleum Corporation seeking to have that corporation lend the necessary funds. The letter stated that a master plan for the entire 4,500 acres was being completed; that it was proposed to start development of 2,000 homes; and that a minimum of 4,000 homes would be completed and occupied within three years and following this, consideration would be given to subdividers capable of proceeding with the development in a satisfactory manner. Although General Petroleum declined to provide the funds, this letter is further evidence that development of the entire tract was being planned.

All of the foregoing discussion amply demonstrates that SBIC was hardly planning, as taxpayer contended (II-R. 71-72), to purchase the land, do nothing with it for 10 years, and at that time consider what to do with it. Rather, these facts indicate quite strongly that development was the primary purpose of acquiring the land. Indeed, in light of the financing arrangement with Kensington, it appears that development was a virtual necessity. We submit that had nothing further occurred other than taxpayer selling his interest in SBIC, these facts alone would have justified a finding by the Tax Court that SBIC had acquired and held the land for sale to customers in the

ordinary course of business. As for the later developments, these, as will be shown, confirm that SBIC held the land for sale, not for investment.

As indicated, SBIC's purchase of the land was clearly predicated on the assumption that the tract would be developed. Because of his efforts on behalf of Kensington Heights Company, taxpayer knew that none of the developers operating in the area were interested in this tract. SBIC could not develop the tract due to taxpayer's desire not to "directly * * * engage in subdividing and developing the land, either individually or through any other business form, because it would place him in competition with his clients and those of his engineering partnership and thus be financially injurious." (I-R. 132.) This fact makes it readily apparent that a solution had to be found whereby development, which had to be done to generate funds for the annual payments, could be insured and possibly regulated by SBIC and yet somehow not reveal taxpayer's role in that function. We submit that the problem was solved by the creation of LMDC. Taxpayer objects (Br. 13-15) to relating LMDC's activities to SBIC, as the Tax Court did, on the grounds that there was no showing that there was any common control of these two entities. However, as will be shown, there were sufficient common interests in these two entities--either through direct ownership or because of financial considerations--so as to justify relating their interests.

Despite that it partakes of a labyrinth, the record does reveal just how inter-related LMDC and SBIC were. All of LMDC's stock was held in trust by Herbert Glaser, as trustee for the corporations which made on the Country Club Park ^{6/} joint venture. (I-R. 121, II-R. 257-258.) It appears that the members of the Country Club Park joint venture were: Sam Glaser; Jack, Charles, and Sam Barenfeld; Herbert Glaser; and Herbert Glaser's grandfather. Sam Glaser was Herbert's father and the three Barenfelds were uncles of Herbert. (II-R. 255-256.) As for the corporations, Sam Berger held a 20% interest in each and Herbert Glaser held a 10% interest in each. (II-R. 257.) Insofar as the Barenfelds and the Glasers controlled the joint venture, we submit that it is a fair and reasonable assumption that they held sufficient interests in the various corporations so as to control them.

Looking at the ownership interests in SBIC, it is apparent that, with the exception of Freeland and Lowthian (who together owned 40% of the partnership), all the effective interests in SBIC were held by persons directly involved in LMDC. Thus Berger held at 20% general partner interest and had control of 20% of the limited partnership interest (as trustee for the HAB and MLB trusts). (I-R. 124.) Berger was also president of LMDC. (I-R. 121, II-R. 258.) The remaining 20% was held by Lake Murray Trust No. 1, which originally consisted of Jack Barenfeld and Sam Glaser, but these two gave a 10% interest to the other members of the Country Club Project. (I-R. 124.) Moreover,

^{6/} Sometimes in discussing the Country Club Park joint venture, reference is made to Chula Vista. It appears that Chula Vista is a location (development) in California where the Country Club Park joint venture was building houses. (II-R. 255-256.)

SBIC's Limited Partnership Agreement provided that in the event of policy differences between the general partners, a board of arbitration would be convened. Of the two specified arbitrators (who would choose the third), one was Herbert Glaser, who, of course, as trustee, had complete control over LMDC. (Pltf. Ex. 15, p. 8.)

Taxpayer's lack of ownership in LMDC is readily explained by his desire not to compete directly with his other clients in development. Insofar as Lowthian was taxpayer's private secretary in his engineering work and his nominee in SBIC, presumably this was why she also was not a stockholder in LMDC. However, it does not follow that taxpayer had no interest in LMDC's affairs for he apparently was to receive a fee from LMDC of \$25 per lot (I-R. 130), plus his engineering partnership was employed by LMDC (I-R. 126). It is possible that taxpayer hoped that as consultant to LMDC and through his engineering partnership, he could exercise some control of LMDC's affairs, even though not a stockholder.

Clearly then, taxpayer's contention that there was no common control is to insist upon the formality that taxpayer and Lowthian, for example, had to be stockholders of record in LMDC; "But the tax law deals in economic realities, not legal abstractions * * *."

Commissioner v. Southwest Expl. Co., 350 U.S. 308, 315; Weinert's Estate v. Commissioner, 294 F. 2d 750 (C.A. 5th).

Once the interlocking relationship of the two entities is recognized, it makes it relatively simple to understand other facts of this case. Thus it is easy to see why, in the original plan between LMDC and SBIC, the latter guaranteed that the cost of off-site improvements would not exceed \$200,000^{7/} and that its cost of the homes to be constructed and sold would not exceed fixed amounts. (I-R. 143.) As the court stated (I-R. 143): "Such undertakings are unusual on the part of a pure seller of acreage and are indicative of a plan for the partners of SBIC to be involved in active development."

Also to be remembered is that taxpayer testified (II-R. 73) that the sale of 500 acres to LMDC would generate sufficient income to pay for the first 5 or 6 annual installments. To purchase the land on this basis, it is obvious that SBIC had to be sure that LMDC would purchase 500 acres. (LMDC had only an option to purchase which, of course, it was not required to exercise.) As the Tax Court concluded (I-R. 142-143): "These interlocking participations provided the real guarantee that the option would be exercised."

In similar fashion, the interlocking relationship explains why LMDC was able to advertise, when LMDC's model homes were shown to the public, that a "City of Tomorrow" was to be developed on the entire

^{7/} The same agreement provided that LMDC deposit \$200,000 for off-site improvements. (I-R. 142.) Thus SBIC was imposing the same condition on LMDC as had been imposed on it, SBIC, by Kensington Heights Company.

4,500 acres. (I-R. 127.)^{8/} It also explains how SBIC, through Berger, was able to represent to Kensington that the entire purchase price would be paid in three years. (I-R. 119.) Further confirmation that Kensington was to be paid in a short period of time is found in the fact that while the SBIC-Kensington contract provided for a 20 year pay-out, SBIC's partnership agreement provided that SBIC was to have a term of 10 years. And, of course, as the Tax Court observed (I-R. 143-144):

A further indication of SBIC's involvement in the development activities of LMDC is contained in the price at which acreage was sold to it by SBIC. The purchase from Kensington and the grant of the option to LMDC took place at the same time. Yet, LMDC was required to pay \$2,000 per acre although SBIC acquired the land from Kensington at \$1,037 per acre (\$800 plus interest). The discrepancy in price is substantial. We recognize that a small portion of the discrepancy may reflect the fact that some of the acreage would be devoted to public purposes such as streets, parks, etc. Perhaps the acreage sold by SBIC to LMDC was more valuable than other portions of the total tract. Petitioners did not see fit to enlighten us on these scores. In our view, the circumstances strongly suggest that the price was arbitrarily arrived at as a method of siphoning off to the common participants in SBIC and LMDC a portion of the latter's profit hopefully as long-term capital gains. In this connection, we note that, while Freeland did not have an ownership participation in LMDC, he could reap his financial reward from that entity via direct personal engineering fees and fees paid in his engineering partnership.

^{8/} Although taxpayer contended (I-R. 127) he disapproved of such advertising by LMDC, it is interesting to note that SBIC's efforts to have the School District acquire acreage for schools, parks, and recreational purposes (I-R. 128-129), if successful, would have been a significant aid towards the creation of a "City of Tomorrow" on the tract. At the very least, SBIC's efforts, again if successful, would have enhanced the value of the land and such efforts cast considerable doubt on taxpayer's contention that SBIC was simply a passive holder of raw acreage (which it hoped would increase in value over a period of years).

In light of all of this evidence, it is obvious that LMDC and SBIC were working in unison to implement SBIC's primary purpose--to sell the land which would in turn be developed. Or as the Tax Court concluded (I-R. 146):

We think that, from the beginning, the partners in SBIC intended to sell off the property as quickly as the area could be made ready for development and that to this end they planned actively and continuously to participate in sequential development efforts. LMDC was the primer for the entire project. It was the first vehicle to be utilized and the partners of SBIC were deeply involved in the activities of that entity.

Taxpayer next contends (Br. 20) that even if there was an inter-relationship between the two entities at one time, this relationship ended when LMDC became insolvent.^{9/} With this as a stepping stone, taxpayer then contends that once the inter-relationship ended, SBIC's original plan to sell the land changed to one of investment. Taxpayer's contention lacks direction for it fails to appreciate that the decline of LMDC does not require that SBIC's

^{9/} Actually, taxpayer suggests (Br. 20) that the inter-relationship ended sometime before this: either when SBIC filed notices of non-responsibility or when LMDC and SBIC entered into an amended agreement. The filing of notices of non-responsibility hardly indicates that these two entities ended their relationship--if anything, it indicates only that SBIC was attempting to maintain the fiction that its only relationship to LMDC was that it had sold land to LMDC. As for the amended agreement, all that occurred was that the purchase price to LMDC was partially reduced; LMDC's "loan" of \$200,000 to SBIC was labeled a "credit"; LMDC's oral agreement to pay taxpayer \$25 for his personal service and counsel was reduced to writing; and removed SBIC's guarantees of lot and off-site improvement costs. We submit that the Tax Court was correct in concluding that this modification was done in order to eliminate disputes arising out of the working relationships between SBIC and LMDC (I-R. 143) rather than being the result of "a bitter breach", as taxpayer contends (Br. 20).

purpose in holding the land had to change. Thus that SBIC intended to have the land developed in order to make sales of land is quite apparent in the record. Equally true is that SBIC was going to utilize LMDC as a vehicle to have the development get under way. LMDC began to develop but then, because of financial difficulties, it went out of business. But this does not mean that SBIC's purpose had to change--as taxpayer states--but only that SBIC might then have had to look for another developer. Stated differently, if a wholesaler is holding inventory for sale to a retailer and the retailer goes out of business, it does not follow that at that moment, the wholesaler's purpose in holding the inventory has changed, so that the wholesaler is now holding the items for investment purposes. In short, we disagree with taxpayer's contention that this fact--LMDC's demise--standing alone necessitates a finding that SBIC's purpose changed accordingly.

Moreover, the facts following LMDC's demise clearly show that SBIC did not change its purpose in holding the land.^{10/} If anything, they reflect that from beginning to end, SBIC planned to sell its land

^{10/} Interestingly enough, taxpayer here, although now also urging there was a change of purpose (the argument was not made to the Tax Court) and suggesting various times at which such change occurred does not ever suggest that the change occurred on or after the date Berger sold out his interests. For this reason alone, we would urge that Morse v. United States, 371 F. 2d 474 (Ct. Cl.), wherein the Court held that there was a change of purpose following Berger's sale, has no application herein. However we believe a more important reason for not applying Morse would be because--in our view--that opinion is in error. If the land was inventory on the date Berger sold (as the Court of Claims appears to have held) and Berger's sale prompted the remaining partner to liquidate, then it would seem the land was still an inventory item. Stated differently, the liquidation of a partnership is not sufficient to convert inventory items into capital assets.

(continued on next page)

to developers and when the first developer (LMDC) failed, then SBIC through its partners) sold the land to another developer (Tavares). Thus LMDC's activities came to an end in May. On August 10, Berger sold his and the trust's interests. In less than a month, i.e., September 7, 1956, taxpayer entered into an option agreement with Tavares, giving Tavares the right to purchase taxpayer's and Lowthian's interests. (Pltf. Ex. 34.) The negotiations for sale of 80% of the partnership occurring within four months from the time the purported change in purpose occurred casts considerable doubt that there ever was in fact an agreement to hold the land for investment. Also, it is difficult to believe that Berger would decide in May to hold the

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Moreover if Berger's sale is the beginning of a liquidation, then presumably SBIC would have been considered to have terminated. Section 708(b)(1), Appendix, infra. Under such circumstances, the partners would be deemed to have sold the assets rather than their partnership interests and under Section 735, Appendix, infra, the gain to the partners would have to be treated as ordinary income. In short, unless the partnership changed its purpose sometime prior to liquidation (that is, Berger's sale) then under Section 735, the land would continue to be considered as an inventory item for at least 5 years. Tibbals v. United States, 362 F. 2d 266 (Ct. Cl.) is not in conflict with the reasoning here because taxpayer there held the land as an individual and thus the law under the partnership sections would not be applicable. More important is that the change of purpose there apparently occurred some time prior to any liquidation sale which is not the situation in the instant case.

land for investment--which would mean making payments on the land but not having any income from the land--when presumably he was already in financial difficulties which necessitated his sale in August. To be remembered is that taxpayer claimed that SBIC would be able to finance the land without selling it (that is, while being held as an investment) either by borrowing on the appreciated value of the land or by having the various partners make contribution. Not only is the record barren of any evidence that either procedure was even discussed by the partners, but Berger's financial difficulties clearly demonstrate that SBIC could hardly have purchased the land on the assumption that the partners would supply the necessary funds as required.

Furthermore, if SBIC had changed its purpose, what then accounts for taxpayer and his nominee, Lowthian, selling their interests? Although taxpayer testified that his sale was against his desires (II-R. 94), this hardly goes to answer the question why taxpayer would sell out after purportedly having decided to hold the land for investment. Insofar as taxpayer was a general partner, he could have had Berger's sale to Tavares set aside (taxpayer agreed to Berger's sale as part of his, taxpayer's, sale agreement with Tavares). Also, even if Berger's sale had been accepted by taxpayer, taxpayer still was one of the two general partners and hence, could have insisted that the alleged reason for SBIC's holding the land be continued, i.e. investment.

The foregoing discloses that any contention by taxpayer that LMDC's demise brought about a change in purpose is a contention without merit. As the Tax Court stated (I-R. 136):

Similarly, the record shows clearly that the plans of SBIC at the time of acquisition of the property continued to govern its subsequent activities so that we are not faced with a situation involving a change of purpose. 11/

This then brings us to taxpayer's last contention (Br. 21), namely, if the gain results solely from the fact that the land has appreciated in value, then the gain has to be taxed as capital gain. Taxpayer's point is not well taken for it is somewhat of a boot strap argument. Thus if the trier of fact determines that the land was simply held as an investment, then the gain is capital gain. If however, the trier of fact determines that the land was being held

11/ Taxpayer's argument (Br. 15-16) that the property must be held for sale is really only a variation of the discussion just concluded. Taxpayer's point--which he did not urge in the Tax Court--appears to be similar to that urged in cases such as Ackerman v. United States, 335 F. 2d 521, 524-525 (C.A. 5th); Bauschard v. Commissioner, 279 F. 2d 115 (C.A. 6th). That is, the purpose for which the property was acquired is not controlling; rather, it is the purpose for which it was being held thereafter. Taxpayer here appears to be urging that SBIC may have planned to hold the land for sale before it acquired the property but once it acquired the land, its purpose changed and from that point onward it was being held for investment. Taxpayer attempts to rely on the record by noting that SBIC had to sell the land to LMDC under the option agreement and because nothing occurred thereafter, the record does not show that SBIC did not change its original purpose. Obviously the record shows no activity on SBIC's part--under the scheme of things, SBIC was awaiting the development of the 500 acres by LMDC before it would take further action and, accordingly, during the interim, SBIC would be passive. Under such circumstances, it would appear incumbent upon the taxpayer to show that SBIC had in fact changed its purpose, not for the Commissioner to show that SBIC had not changed its purpose. Moreover, taxpayer offers no reason that would have prompted SBIC to change its purpose once it acquired the land.

for sale to customers in the course of trade, i.e., not as an investment, then taxpayer would have the Court determine if the land increased solely from outside forces (growth of a city, etc.), and if so, then the Court would have to say the land was an investment. If so, then the Court's entire inquiry as to the purpose for which the land was being held would be vitiated by this one fact. True, business activities will usually result in a higher price for the land but if a dealer bought acreage, admittedly held it as part of his inventory, making many efforts to sell, and then the land increases because a business has decided to locate nearby, then taxpayer would urge the land had not been held for sale to customers. We submit that such a conclusion would be contrary to the capital gains provisions. Even if taxpayer's analysis were correct, the fact is that the land increased because of development work, not because of appreciation. Thus Tavares stated (Dep. 19-20) that development of the 150 acres had increased the value of that land and the contiguous property as well. In other words, the work done by LMDC, which presumably included some--if not all--the off-site improvement work required by SBIC gave rise to the land's increase in value. Insofar as SBIC's agreement with LMDC virtually assured that the work would be done, the development work, although done in LMDC's name, must be attributed to SBIC. Accordingly, it is not unrealistic to say that SBIC's efforts gave rise to the increase in value.

In the final analysis, the Tax Court found that taxpayer did not carry his burden in proving that this land was not being primarily held for sale to customers in the ordinary course of business. There is

ample evidence in the record to support this finding and taxpayer has not shown it to be clearly erroneous.

CONCLUSION

For the foregoing reasons the decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

MITCHELL ROGOVIN,
Assistant Attorney General.

LEE A. JACKSON,
DAVID O. WALTER,
MARCO S. SONNENSCHN, Attorneys,
Department of Justice,
Washington, D. C. 20530.

NOVEMBER, 1967.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: _____ day of _____, 1967.

Marco S. Sonnenschein
Attorney

APPENDIX

Internal Revenue Code of 1954:

SEC. 708. CONTINUATION OF PARTNERSHIP.

*

*

*

(b) Termination.--

(1) General rule.--For purposes of subsection (a), a partnership shall be considered as terminated only if--

(A) no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership, or

(B) within a 12 month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.

*

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(26 U.S.C. 1964 ed., Sec. 708.)

SEC. 735. CHARACTER OF GAIN OR LOSS ON DISPOSITION OF DISTRIBUTED PROPERTY.

(a) Sale or Exchange of Certain Distributed Property.--

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*

(2) Inventory items.--Gain or loss on the sale or exchange by a distributee partner of inventory items (as defined in section 751(d)(2)) distributed by a partnership shall, if sold or exchanged within 5 years from the date of the distribution, be considered gain or loss from the sale or exchange of property other than a capital asset.

*

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(26 U.S.C. 1964 ed., Sec. 735.)

SEC. 741. RECOGNITION AND CHARACTER OF GAIN OR LOSS ON
SALE OR EXCHANGE.

In the case of a sale or exchange of an interest in a partnership, gain or loss shall be recognized to the transferor partner. Such gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset, except as otherwise provided in section 751 (relating to unrealized receivables and inventory items which have appreciated substantially in value).

(26 U.S.C. 1964 ed., Sec. 741.)

SEC. 751. UNREALIZED RECEIVABLES AND INVENTORY ITEMS.

(a) Sale or Exchange of Interest in Partnership.--The amount of any money, or the fair market value of any property, received by a transferor partner in exchange for all or a part of his interest in the partnership attributable to--

(1) unrealized receivables of the partnership, or

(2) inventory items of the partnership which have appreciated substantially in value,

shall be considered as an amount realized from the sale or exchange of property other than a capital asset.

*

*

*

(d) Inventory Items Which Have Appreciated Substantially in Value.--

(1) Substantial appreciation.--Inventory items of the partnership shall be considered to have appreciated substantially in value if their fair market value exceeds--

(A) 120 percent of the adjusted basis to the partnership of such property, and

(B) 10 percent of the fair market value of all partnership property, other than money.

(2) Inventory items.--For purposes of this subchapter the term "inventory items" means--

(A) property of the partnership of the kind described in section 1221 (1),

*

*

*

(26 U.S.C. 1964 ed., Sec. 751.)

SEC. 1221. CAPITAL ASSET DEFINED.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include--

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

*

*

*

(26 U.S.C. 1964 ed., Sec. 1221.)

SEC. 1222. OTHER TERMS RELATING TO CAPITAL GAINS AND LOSSES.

For purposes of this subtitle--

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(3) Long-term capital gain.--The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing gross income.

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(26 U.S.C. 1964 ed., Sec. 1222.)

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No. 21795

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FOR THE NINTH CIRCUIT

ESTATE OF EUGENE L. FREELAND, Deceased, by SECURITY FIRST NATIONAL BANK, a national banking association, Executor, and VERA GOOD FREELAND, by L. N. TURRENTINE, Conservator,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' REPLY BRIEF.

GEORGE T. ALTMAN,

424 South Beverly Drive,
Beverly Hills, Calif. 90212,

FRANK KOCKRITZ,

JAMES W. ARCHER,

GRAY, CARY, AMES & FRYE,

14th Floor, Bank of America Bldg.,
San Diego, Calif. 92101,

Attorneys for Petitioners.

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Petitioners,

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' REPLY BRIEF.

Comment on Respondent's "Statement."

Rule 18(3) of this Court very plainly states that no statement of the case is required of an appellee "unless that presented by appellant is controverted." But respondent here does not controvert a single sentence—even a single word—of petitioners' statement of the case. We could therefore properly ask this Court to ignore respondent's very lengthy statement in its entirety. But we need not do that. Indeed, respondent's statement reveals his reasons for disregarding this rule of the Court and presenting what appears intended as his own separate, very detailed, and complete statement of the case.

It is significant there that respondent gives weight to evidence which the Tax Court itself indicated deserved no weight. Thus, the Tax Court clearly indicated that it had no faith in Sam Berger's statements. [Tr. 212, lines 2-16.] One Theodore Jacobs, respondent's witness, had testified that Berger was a "common liar." [Tr. 210, line 12.] Yet respondent sets forth, Br. 6, Berger's representation to Kensington, Sam Berger Investment Company's vendor, that the purchase price would be paid off in about three years. And the principal evidence relied upon by respondent to show that the initial purpose of Sam Berger Investment Company was to develop the 4,500 acres consists, Br. 13, of public representations by Berger of which Freeland disapproved.

Significantly also, respondent's statement of the case sets forth in detail, Br. 9-10, the provisions of the original agreement, executed November 23, 1954, between Sam Berger Investment Company and Lake Murray Development Company. He does not mention the notices of non-responsibility filed on February 3, 1955, by Sam Berger Investment Company. And when he comes, Br. 15, to the changes made by the amended agreement of July 1, 1955, he omits to observe that it left no element of liability of, or gain to, Sam Berger Investment Company in connection with the activities of Lake Murray. What was left was an agreement which Sam Berger Investment Company could have made, in the light of its own purchase agreement, with any purchaser from it of a part of the acreage involved.¹

¹By a footnote, Br. 19, respondent suggests that petitioners "conceded" that respondent had not abused his discretion in re-opening the taxable year 1956. Petitioners have, however, not so conceded; they have only elected not to raise that issue before this Court.

Reply to Respondent's "Summary of Argument."

In his "Summary of Argument," respondent again refers to Berger's representation that the purchase price of the property would be paid off in three years. There respondent again also relies on the original agreement between Sam Berger Investment Company and Lake Murray Development Company, especially, Br. 21, the guarantee contained therein by Sam Berger Investment Company of off-site costs. Respondent also refers to the offers of land by Sam Berger Investment Company to the School Board, although sales to that Board were required by the conditions of annexation of the property, conditions thus imposed long before Sam Berger Investment Company came into existence. Then respondent says that shortly after the demise of Lake Murray 80% of Sam Berger Investment Company was sold, an "unlikely event" if that company had decided to hold the property for investment. But he fails to note there that the owner of half of that 80%, Sam Berger, was himself then financially defunct, and that Tavares, the purchaser, and largest developer in the area, after he had bought Berger's half had asked the owners of the other half, including petitioners, to join with him in the development of the property and that they had refused. If they had been interested in development of the property they would have grasped at the chance. Indeed, Tavares had difficulty even in getting a price from petitioners for their interest. The clear conclusion is that their only purpose was to hold the property and certainly not to develop it.

Reply to Respondent's "Argument."

The Clearly Erroneous Rule.

Coming to respondent's "Argument," respondent begins, Br. 23, by pointing out the "clearly erroneous" rule applicable where the issue is strictly one of fact. But respondent's failure to controvert even a sentence of petitioner's "Statement," and his citation of numerous cases and statutory provisions, including attempted resort to sections of the Internal Revenue Code, 708 and 735, never mentioned by the Tax Court, contradict his assumption that the issue is strictly one of fact. Findings of fact are not binding upon this Court if they are induced by an erroneous view of the law. *Municipal Bond Corporation v. Commissioner* (CA 8), 382 F. 2d 184, 188 (1967). Nor are they binding upon this Court under the clearly erroneous rule if they are against the clear weight of the evidence. *Municipal Bond Corporation v. Commissioner, supra*, also at page 188.

In this connection respondent, as to the "normal criteria" in the problem here, says, Br. 23, that taxpayer notes they are lacking. As we pointed out, however, in our opening brief, at page 13, it was the Tax Court which observed those criteria were lacking. And contrary to respondent's implication, Br. 24, the absence of those criteria is an important factor here. *Hoover v. Commissioner*, 32 T.C. 618, 625.

In this connection also, respondent's fixation with the original agreement between Sam Berger Investment Company and Lake Murray, his repetition again and again of details thereof which do not appear in the amended agreement, and his blind disregard of the breach between the two entities which resulted in the

amendment, are especially significant. The purpose for which property was originally acquired or held is not determinative if that purpose has changed; the question is then whether the property was or was not held for sale to customers, in the ordinary course of trade or business, during the time ended by its sale. *Bynum v. Commissioner*, 46 T.C. 295, 299 (1966), citing *Mauldin v. Commissioner* (CA 10), 195 F. 2d 714, 717; *Todd Tibbals v. U.S.* (Ct. Cls.), 362 F. 2d 266, 273.

The Findings and Evidence.

Coming under his "Argument" to the findings and evidence, respondent concedes, Br. 26, footnote, that the members of Sam Berger Investment Company included men who were wealthy, men whose assets were as great as the entire amount which was owing on the land, which amount, moreover, was payable in installments over a period of *twenty years*. It is impossible to say therefore that they could not have held the land without selling any part of it, at least for a long time, and without even borrowing against it. Respondent's point there that there was no agreement for contributions by the individual members in such case is meaningless, since they could individually have advanced money by way of loans, and certainly would have done so as long as the equity was worth holding. Nor, since the land had greatly appreciated in value, is there any support for the notion necessarily implied by respondent that the property could not have been refinanced. Nor is there any support for the notion also necessarily implied by respondent that when a person invests in a property with payments spread over twenty years he is normally prepared at the very outset to pay off the total amount.

Respondent next repeats, Br. 27, his contention that petitioner's selling his interest alone justified a finding that the partnership was holding the property for sale to customers in the ordinary course of business. Of course, this begs the question. And the evidence is to the contrary. As observed above petitioners were first asked to join their purchaser, Tavares, in the development of the property but refused, and it was difficult for Tavares even to get a price. The very reluctance to sell is significant. *Municipal Bond Corporation v. Commissioner*, 46 TC. 219, 233, citing *Commissioner v. Pontchartrain* (CA 5), 349 F. 2d 416; affirmed and reversed on other issues, 382 F. 2d 184, *supra*. Indeed, under the facts the sale by petitioners was a forced sale; they did not want to develop the land, so that, because of Berger's sale to Tavares, whose purpose was the opposite, to develop the land, it would have been difficult for petitioners if they did not also sell. [Tavares dep., pp. 10-12.] Thus their very sale shows beyond question, we submit, that petitioners had no interest in development of the property but wanted only to hold it.

Next, Br. 28-29, respondent attempts, for the purpose of showing an interlocking of Sam Berger Investment Company and Lake Murray, to rely on "common interests" in those two entities. But he does not deny that almost immediately after the purchase of the property there was a rupture between those two entities, which never was healed. To treat them as "common" is simply to deny the record. As respondent concedes, Br. 11, par. (d), nothing could be done in the management of the partnership without Freeland's consent; and within two months after the partnership

agreement was executed Freeland made it clear by notices of non-responsibility that the partnership wanted no responsibility for the activities of Lake Murray, in which, except under a fee agreement for engineering services, he had no interest. Nor is there any showing whatever that, as respondent implies, Br. 29, the Barenfelds and Glaser, who, he says, were the persons who controlled Lake Murray, through the Country Club Park joint venture, were anything in Sam Berger Investment Company but the minority and strictly limited partners which they were; nor, as respondent implies, Br. 30, that Freeland as mere consulting engineer to Lake Murray was able to control that entity. Under very similar facts in a case just decided by the Tax Court, *Robert E. Ronhovde*, 26 T.C.M. 1251 (Dec. 1967), that court, at page 1258, recognized that the taxpayer's position as promoter and minority shareholder of the development corporation, to which the partnership there sold the land involved, did not taint the character of the partnership, as one holding the property for sale to customers in the ordinary course of trade or business, even though he was promoter, manager, and member of it also.² There is nothing whatever to support a notion of common control of the two entities here; and the actual activities between them completely negative it. Those are the "economic realities" for which respondent himself, Br. 30, contends. And, of course, after the total demise of Lake Murray, on May 4, 1956, more than half a year before Freeland sold his interest in Sam Berger In-

²CCH's original headnote on this case was erroneous. Petitioners are advised that it has since been corrected.

vestment Company, no relation between those two entities could exist.

Respondent, as his argument proceeds, continues to cling tenaciously to the original agreement between the two entities. He refers, Br. 31, to the "original plan" between them, in particular to the guarantee which it contained, by Sam Berger Investment Company, of the off-site and lot improvement costs. This he quotes the Tax Court as showing that this undertaking was unusual on the part of a pure seller of acreage. Sam Berger Investment Company had to get from Lake Murray the \$200,000 which it needed to make the purchase in the first place, so that the agreement with Lake Murray was in effect a condition of the purchase. And those guarantees, which respondent there also quotes the Tax Court as calling the "interlocking participations," were eliminated in the amended agreement. This obviously is the reason that the latter agreement respondent studiously disregards.

In the same vein of reliance upon pre-amendment factors respondent, Br. 31-32, repeats Berger's initial bombast, about development of the 4,500 acres and pay-off in three years, which as observed above in relation to respondent's "Statement" the Tax Court itself indicated deserved no weight. Also, by footnote, Br. 32, respondent refers again to the offers by Sam Berger Investment Company to the School District in respect to acreage for schools, et cetera. Respondent refers to those offers as "efforts" of Sam Berger Investment Company, but no "efforts" by it were required. The right of the School District to acquire such acreage was provided for in the conditions of annexation of the property, and this was long

before Sam Berger Investment Company was formed. All that the record shows is that that company was trying to conform to those conditions.

Respondent also here, Br. 32, quotes the Tax Court in reference to the price Lake Murray was required to pay under its option. We covered that point clearly and adequately in our opening brief, in the paragraph beginning at the bottom of page 14. But respondent makes no effort to reply. We must assume that he cannot.

Respondent finally, in a brief footnote, Br. 33, touches the issue of the amended agreement. But he does not say how the amendments left the agreement between the two entities. He refers to the disputes, as does the Tax Court, as arising out of the "working relationships" between the two entities. Just how a guarantee of costs could be a mere "working relationship," he does not explain. He does not deny that the amendments, as petitioners pointed out in their opening brief at page 7, eliminated the entire scheme of liability and gain of Sam Berger Investment Company in connection with the activities of Lake Murray. Nor does he even explain how the disputes arose if the two entities were "interlocked." It is no wonder that in every reliance of his on the agreement between the two entities he refers to the provisions of the original agreement, as if the amendments never took place.

Respondent next, Br. 34, insists that Lake Murray's demise cannot be used to predicate a change of purpose. But Lake Murray was not, in the beginning, a mere vendee. Without it Sam Berger Investment Company could not have obtained the off-site deposit of \$200,000 required by its own vendor, Kensington. This

need was gone, and it did not have to be repeated. And it is *entirely* from the activities of Lake Murray, not as a buyer, but as an asserted “interlocking” entity, that the Tax Court drew its conclusion as to the character of the holding by Sam Berger Investment Company. Indeed, respondent, Br. 34-35, attempts to place a wholly unrelated entity, Tavares, in the same position merely because he was a developer, as if the purpose of the buyer, not the taxpayer, has any bearing on the issue. There is no basis whatever for saying that the characterization of Sam Berger Investment Company based on Lake Murray survived Lake Murray.

Next respondent, Br. 35-36, wonders why petitioner sold if he was holding the property for investment and not for development. But as we have pointed out above, Freeland was invited to join Tavares in development of the property and refused, and Tavares even had difficulty in getting a price from Freeland. Then why did Freeland sell, respondent appears to ask. Indeed, why does any investor sell, and what would the capital-gain provisions be for if an investor never sold? And how many investors do not sell when the price is high enough?

In reference to *Todd Tibbals v. United States*, *supra*, respondent in a footnote, Br. 35, says that it is inapplicable here because there the holding taxpayer was an individual, not, as here, a partnership. But there is absolutely no difference under the law between an individual and a partnership on the question whether, at the critical date, the property was or was not held for sale to customers in the ordinary course of trade or business. In regard to that case we refer to the detail of it shown in our opening brief, at pages 18-19. As we

pointed out there, the case here is clearer on the issue of change of purpose involved. Assuming here that the original purpose was to hold the property for sale to customers in the ordinary course of trade or business, the change from that purpose, even dating it from the demise of Lake Murray, or even from as late as Berger's sale to Tavares, occurred at all events before the sale by petitioners, and it is the date of that sale which is the critical one in determining the purpose of holding.³

Respondent then comes, Br. 37, and in a footnote there, to the Tax Court's finding that the plans of Sam Berger Investment Company at the time it acquired the property continued to govern its subsequent activities and that therefore we are not faced with a situation involving a change of purpose. Obviously, of course, since the Tax Court itself thus raised that question, it cannot be said, as respondent does, Br. 21, that we are raising it here for the first time. On that issue we will not repeat our analyses in respect to it given before.

Finally, Br. 37-38, respondent attempts to connect the increase in value of the property with activities of

³In the same footnote respondent attempts to involve Section 735 of IRC 1954 on the theory that, under Section 708(b)(1), Sam Berger Investment Company terminated when Sam Berger sold his interest, wherefrom he would invoke the character of holding on that date instead. But he points out nothing in the record to support the factual conditions required by Section 708(b)(1), either complete cessation of activity or a sale by that date of at least 50 per cent of the partnership. The partnership actively farmed the property, from 1954 through 1956 [T.C. 19; testimony of Margaret C. Lowthian, Tr. 184, lines 17-20]. And Berger's sale on August 10, 1956, was of only 40% of the partnership. Of course, this presents no issue anyway because, as shown, the purpose of holding for which respondent contends, predicated wholly on a relation to Lake Murray, necessarily terminated before Berger's sale.

Sam Berger Investment Company. He makes no attempt to say, which he could not, that that partnership, except for its farming of the land, had any activities at all. He again imputes to it the activities of Lake Murray. What he says is that the improvement of 150 acres by Lake Murray added value to the remaining 4350 acres as contiguous property, therefore the gain on the sale by petitioners of their interest in Sam Berger Investment Company was attributable to the activities of Lake Murray.

In the first place, the testimony involved related only to the effect which the improvement of the 150 acres had on the "contiguous property". [Travares dep., p. 19, line 26, to p. 20, line 2.] It could hardly be said that the entire 4350 acres were "contiguous" to the 150. Perhaps the 350 remaining under Lake Murray's option could be so described, but certainly not the other 4,000 acres, owned by Sam Berger Investment Company free of option. That would be like saying that the entire Pacific Ocean was "contiguous" to California.

Besides, if Lake Murray's gross failure on 150 adjoining acres added value to the partnership's land, the success of Bollenbacher & Kelton on 1300 adjoining acres must have added at least eight times as much value to the partnership's land. And how about the six or seven thousand homes built by Tavares alone in the San Diego area and the as many lots which he sold to other builders? And how about the rapid growth of San Diego generally, with the resulting continuing and substantial increase in its real estate values? All of this is pointed out in our opening brief, at pages 8-9.

But more important is the fact that even if Sam Berger Investment Company itself had improved that

150 acres of Lake Murray, the resulting incidental increase in value, if any, of the land which it still owned when petitioners sold their partnership interest would have been irrelevant. A person can develop a portion of a parcel of land, and if he does not hold the remainder of the parcel primarily for sale to customers in the ordinary course of his trade or business the gain by him on that remainder is capital gain. The sole question, under the statute, is the purpose for which the property involved in the sale at issue was, at the relevant time, primarily held. *Malat v. Riddell*, 382 U.S. 900.

Conclusion.

We submit in conclusion that the Tax Court's determination was based on erroneous imputation to Sam Berger Investment Company of the activities of Lake Murray, erroneous extension of that imputation from the 500 acres of Lake Murray, 150 being developed and 350 held under option by it, to the 4,000 acres of Sam Berger Investment Company in which Lake Murray had no interest, and, assuming that that imputation and that extension were proper at the beginning of the relation of those two entities, the erroneous disregard of the radical changes which subsequently occurred in that relation, and even of Lake Murray's demise. We submit therefore that that Court erred and should be reversed.

Respectfully submitted,

GEORGE T. ALTMAN,

Attorney for Petitioners.

Certificate.

I certify that, in the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

GEORGE T. ALTMAN

No. 21,795

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Respondent.

PETITION FOR REHEARING.

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424 South Beverly Drive,
Beverly Hills, Calif. 90212,

FRANK KOCKRITZ,

JAMES W. ARCHER,

GRAY, CARY, AMES & FRYE,

14th Floor, Bank of America Bldg.,
San Diego, Calif. 92101,

Attorneys for Petitioners.

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COMMISSIONER OF INTERNAL REVENUE,

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PETITION FOR REHEARING.

Petitioners now petition this Court for rehearing, upon the grounds stated below. Petitioners submit that at least this case should, under 28 U.S.C. §2106, be remanded to the Tax Court for further proceedings so that that Court may reexamine the record, and that Court and the parties take any other proper procedures, from the standpoint of the grounds for this petition stated below.

Petitioners also suggest, under Rule 23(5) of this Court, that this case should be reheard en banc, chiefly because of the uncertainties, pointed out below, expressed this Court's opinion, and the doubt of respondent himself, pointed out in paragraph 6 below, that this Court's opinion supports its judgment.



Grounds of Petition.

The grounds of this petition are solely errors of law on the face of this Court's opinion, and conflicts between its opinion and its judgment, as follows:

1. This Court, at page 17¹, quotes, and appears heavily to rely upon, several factual inferences of the Tax Court. Such inferences, if not "mere suspicion," but factual conclusions based on "informed experience with human affairs," would come within the "clearly erroneous" rule. *Commissioner v. Duberstein*, 363 U.S. 278, 292, 80 S. Ct. 1190, 1200. The inferences here, however, are framed in the very language of suspicion. Nor do they indicate a basis of informed experience.

For example, as shown at p. 5, the 4500 acres, a mere seven square miles, "contained a lake, some canyons, and a mountain rising about 1100 feet above the surrounding terrain." Also, as to the mountain, the cost of off-site improvements, as shown at p. 13, was found to be prohibitive even at the foothills. Simple arithmetic would show that even with an average slope as high as 25%,² the mountain alone, with a floor radius then of 4400 feet, would rule out as unusable one-third of the 4500 acres. Yet the Tax Court used SBIC's average cost per acre based on the entire 4500 acres in order to treat its selling price to LMDC as a scheme for despoiling the federal revenue.

We give the above only as one example of the character of the inferences made. Most of the others cited at p. 17 are of like character. We submit that those inferences, just as their very wording shows, do not rise above the level of mere suspicion.

2. This Court states, at p. 18, that, as to SBIC's original purpose, the Tax Court "might possibly have

¹The page references herein, if not otherwise identified, are to this Court's slip opinion.

²The maximum grade provided in San Diego is 15%. Council Resolution No. 173217.

properly found in petitioners' favor"; and that, as to petitioners' contentions of change of purpose, they "are admittedly not without support," and there would "perhaps have been considerable basis for a finding" in accordance with them. But, this Court says, at p. 19, the burden of proof was on petitioners.

What is required of petitioners because of their burden of proof is the preponderance of the evidence, evidence therefore showing that the facts asserted by them are more probably true than false. *Burch v. Reading Co.* (C.A.3), 240 F. 2d 574, 579, cert. denied 353 U.S. 965. The Supreme Court has stated that requirement as the evidence which "would reasonably support a verdict for a plaintiff in an ordinary action for the recovery of money." *Burnett v. Niagara Falls Brewing Co.*, 282 U.S. 648, 654, 51 S. Ct. 262, 265; 2 Casey's Federal Tax Practice §8.7 at fn. 45, 9 Mertens §50.62 at fn. 23. We submit that what this Court has in fact said here, in effect, is that petitioners have carried their burden of proof.

The burden of proof rule, moreover, may not be applied to defeat justice. *Helvering v. Taylor*, 293 U.S. 407, 55 S. Ct. 287, 9 Mertens §50.62 at fn. 22, §50.65 at fn. 60. Clearly, this Court's own statements, quoted above, show that the evidence was adequate to support petitioners, so that a decision against them would be inconsistent with justice. This is true here all the more because the tax asserted would, as shown in our opening brief, at pp. 10-11, consume the entire estate. It is also emphasized by the Tax Court's recent contrary decision in *Ronhovde v. Commissioner*, 26 T.C.M. 1251, cited and summarized in our reply brief at p. 7.

3. This Court states, at p. 18, that the "clear purpose of denying capital gain treatment to profit attributable to the sale of inventory is to prevent the owners of businesses yielding ordinary income from in effect reducing their tax liability on such income merely

by selling their businesses *in toto*.” In the first place, there is no evidence or experience supporting the idea that a person would be likely to dispose of a business yielding income just to reduce his tax liability. In the second place, the clear purpose of the statutory provision, as found by the Supreme Court, was to deny capital gain treatment to the “profits and losses arising from the everyday operation of a business.” *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 52, 75 S. Ct. 20, 24. The sale of a business *in toto* could hardly be the same as the everyday operation of the business.

In the third place, this Court, in its statement quoted above, by using the term “inventory” clearly begs the question. So this Court does again when it next says that denial of capital gain treatment to inventory “would in many instances be frustrated if an intention to ‘liquidate’ such a business sufficed to establish the sort of ‘change of purpose’ which petitioners contend occurred here.” The land involved here, if classified as inventory during the relevant period, would be so classified only if it was then held primarily for sale to customers in the ordinary course of the taxpayer’s trade or business. This Court, at pp. 2-3, makes that point clear. Therefore, to speak of the property involved here as inventory begs the very question at issue here, whether during the relevant period it was inventory.

In the fourth place, and more important still, there is no finding here of sale of a business, or *in toto*. The sale in each case was only of an interest in the partnership, SBIC. Thus after the sale by Berger the land was still held in partnership.³ But there was a very important change. Berger, the promoter, Berger, the partner upon whose statements and activities the Tax

³This would also be true if the land was regarded as thereafter held by a constructive successor partnership resulting from the sale. Treasury Regulations, Sec. 1.708-1(b)(1)(iv).

Court almost wholly relied for its conclusion as to original purpose, he was out, and Freeland, the only remaining general partner, refused to join Berger's vendee in development of the property. (Pp. 5, 9, 14.) The situation was the same in effect as if Berger had died. Calif. Corp. Code §15520. Whether liquidation followed or not, the purpose of holding the land after Berger's sale could not be tied to the purpose before. *Estate of Ferber*, 22 T.C. 261, 264, formally acquiesced in by respondent, 1954-2 C.B. 4. See also *Greenspun v. Commissioner* (C.A. 8, 1956), 229 F. 2d 947, 953, 46 A.L.R. 2d 615, 706 §24 at fn. 19.

4. At pp. 18-19, this Court finds it "quite conceivable" that, during the period after Tavares' entry into SBIC, SBIC's purpose regarding the land "was to some degree not clearly defined." This Court does not say there that the *evidence* was unclear. What this Court plainly says there is that what the evidence did establish was that SBIC's purpose, which it would find as a "legal construct" in SBIC's composite mind, was not, in that mind itself, clearly defined.

With this we need not disagree. The purpose regarding the land required to support respondent's determination was a purpose, of SBIC, during the period above referred to, to hold the land "primarily for sale to customers in the ordinary course of [its, SBIC's,] trade or business." I.R.C. 1954, Sec. 1221(1). The burden of petitioners was therefore to prove that sale to customers in the ordinary course of SBIC's trade or business was not SBIC's *primary* purpose regarding the land during that period. But if SBIC's purpose regarding the land was not clearly defined *in SBIC's own mind*, that purpose could be substantial but not primary. See, in Professor Kenneth Burke's monumental work entitled "A Grammar of Motives," the analysis, pp. 51-53, under the subtitle "The

Rhetoric of Substance.”⁴ Petitioners’ burden was therefore fully carried if their proof was that SBIC’s purpose “was to some degree not clearly defined.”

5. The “clearly erroneous” rule upon which this Court relies, at p. 19, does not apply, it is clear, to a finding induced by an error of law. *Hoover Co. v. Mitchell Manufacturing Co.* (C.A. 7, 1959), 269 F. 2d 795, 808; *Municipal Bond Corporation v. Commissioner* (C.A. 8, 1967), 382 F. 2d 184, 188. We submit, therefore, upon the basis of the errors of law shown above, that the “clearly erroneous” rule has no application here.

6. Respondent himself apparently is concerned that this Court’s opinion does not support its judgment of affirmance. On March 28, 1968, after two extensions of time, the government filed in the United States Court of Claims, in docket Nos. 70-65 and 73-65 there, being suits for refund by other partners of SBIC involving the same issue as here, a brief citing several times, and discussing, the case here as decided by the court below, and noting its pendency here on appeal, but making no reference to the opinion or decision therein of this Court, although obviously available to the government long before said brief was filed.

Respectfully submitted,

GEORGE T. ALTMAN,
FRANK KOCKRITZ,
JAMES W. ARCHER,
GRAY, CARY, AMES & FRYE,

By GEORGE T. ALTMAN,
Attorneys for Petitioners.

⁴Professor Burke was visiting lecturer at Harvard during its 1967-1968 year.

No. 21795-A

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MARGARET C. LOWTHIAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S OPENING BRIEF.

ADAM Y. BENNION,

523 West 6th Street,

Suite 828,

Los Angeles, Calif. 90014,

CHARLES E. BURCH, JR.,

JOHN B. GREGORY,

2101 First National Bank Bldg.,

San Diego, Calif. 92101,

Attorneys for Petitioner.

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WM B LUCK CLERK

OCT 11 1967

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S OPENING BRIEF.

Jurisdiction.

This is a petition to review a decision of the Tax Court of the United States determining deficiencies in petitioner's Federal income tax liability for the calendar years 1956, 1957, 1958 and 1960.

Having received a notice of deficiency from respondent, petitioner, on October 19, 1964, filed her petition for redetermination with the Tax Court of the United States (Document No. 5; Tax Court General Docket No. 5182-64, p. 1). On December 30, 1966, the Tax Court entered its Memorandum Findings of Fact and Opinion (Document No. 34; reported at 25 TCM 1473, T.C. Memo 1966-283), and its Decision (Document No. 36), sustaining the deficiencies. (Tax Court General Docket, p. 3.) The jurisdiction of the Tax Court was based upon Sections 6213 and 7442 of the Internal Revenue Code. (United States Code, Title 26, Secs. 6213 and 7442.)

Petitioner filed her petition for review by this Honorable Court on March 29, 1967. (Document No. 41, Tax Court General Docket, p. 3.) The jurisdiction of this Court is based upon Sections 7482 and 7483 of the Internal Revenue Code. (United States Code, Title 26, Secs. 7482 and 7483.)

Statement of the Case.

The principal issue below was whether gain from a sale admittedly realized by petitioner was properly reported as long-term capital gain, or whether, as respondent determined, such gain should be taxed to petitioner as ordinary income.

An alternative issue below was whether respondent abused his discretion in permitting a reopening of the audit of petitioner's return for the taxable year 1956, the first year in controversy, more than three-and-one-half years after his agents had, in 1957, examined and accepted the return as filed.

On this petition for review petitioner urges that the gain did constitute capital gain and was taxable as such; furthermore, that respondent did in fact abuse his discretion, as alleged in the Court below; and that the Tax Court erred in its decision to the contrary on both issues.

The gain in controversy resulted from the following transaction:

Petitioner, a single woman, was a limited partner in a partnership known as Sam Berger Investment Company (referred to herein as "SBIC"), having an 8 percent interest as such limited partner. [TC 2, 11; this and other references to "TC" herein are to pages of the

Tax Court's Memorandum Findings of Fact and Opinion, Document No. 34.]

The limited partnership was organized on August 6, 1954, the partners and their respective interests being as follows [Ex. 15]:

<i>General Partners</i>	<i>'Percentage Interest</i>
Eugene L. Freeland	32%
Sam Berger	20%
<i>Limited Partners</i>	
Lake Murray Trust No. 1	20%
HAB Trust, c/o Sam Berger	10%
MPB Trust, c/o Sam Berger	10%
Margaret Lowthian	8%

On or about November 26, 1956, petitioner sold her 8 percent limited partnership interest in SBIC for the sum of \$220,000.00, which she received in installments during the ensuing years, including the taxable years in controversy. [TC 18; Stip. of Facts, para. 32, Document No. 22.] As stated above, petitioner reported gain from the sale as long-term capital gain and elected to use the installment basis.

Petitioner for many years had been and during the years in controversy was Eugene L. Freeland's secretary. Freeland was and had been a full-time civil and structural engineer. [TC 3.] As shown above, Freeland was one of the two general partners of the SBIC limited partnership, owning a 32 percent interest therein. He also sold his interest in the partnership at the same time petitioner sold her interest. [TC 18.] Respondent determined that his gain, likewise, was taxable as ordinary income. Petitioner's case and Freeland's case

were consolidated for trial in the Tax Court. Without explanation or elaboration the Tax Court stated in its Findings of Fact [TC 3]:

“* * * The tax treatment accorded to Freeland will control with respect to the tax treatment of the transactions as far as Lowthian [petitioner] is concerned.”

The general rule in Section 741 of the Internal Revenue Code provides for capital gain treatment upon the sale of a partnership interest, as follows:

“Sec. 741. Recognition and Character of Gain or Loss on Sale or Exchange.

“In the case of a sale or exchange of an interest in a partnership, gain or loss shall be recognized to the transferor partner. Such gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset, except as otherwise provided in section 751 (relating to unrealized receivables and inventory items which have appreciated substantially in value).”

The exception in Section 751 is as follows:

“Sec. 751. Unrealized Receivables and Inventory Items.

“(a) Sale or Exchange of Interest in Partnership.—The amount of any money, or the fair market value of any property, received by a transferor partner in exchange for all or a part of his interest in the partnership attributable to—

- (1) unrealized receivables of the partnership, or
- (2) inventory items of the partnership which have appreciated substantially in value,

shall be considered as an amount realized from the sale or exchange of property other than a capital asset.

* * *

“(d) Inventory Items Which Have Appreciated Substantially in Value—

* * *

(2) Inventory Items—For purposes of this subchapter the term ‘inventory items’ means—

(A) property of the partnership of the kind described in section 1221 (1).

* * *

Property described in Section 1221(1) is—

“(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;”

Hence, the basic issue here is whether the property of the limited partnership was, at the time of the sale by petitioner of her partnership interest, “held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.”

The important facts bearing upon this issue are as follows:

The limited partnership SBIC was organized on August 6, 1954 for the specific purpose of purchasing, and it did in fact purchase, approximately 4,500 acres of land known as the Waring Ranch, which had been annexed to the City of San Diego, California, in December 1953. [TC 5.] The purchase price was \$4,-

676,666.66, payable \$100,000.00 down and the balance in 20 annual installments. [TC 6.] Freeland provided \$70,000.00 and Berger provided \$30,000.00 of the money used for the down payment. [TC 7.] The purchase escrow agreement contained provisions for the release of 150 acres against each annual payment, and for the deposit of \$200,000.00 by the purchaser for off-site improvements upon instructions from the seller. [TC 6.]

Berger was a real estate developer. [TC 5.] His associates in other real estate developments, referred to by the Tax Court as the "Barenfeld-Glaser Group", put up the \$200,000.00 for the required off-site improvements and in return received (1) a 20 percent interest in the SBIC limited partnership (taken in the name of "Lake Murray Trust No. 1", as shown in the above statement of partners) and (2) an option to buy 500 acres of the 4,500-acre Waring Ranch then being purchased by the SBIC limited partnership. [TC 8-9.]

This 500-acre option was actually taken in the name of a newly-organized corporation known as Lake Murray Development Company (referred to herein as LMDC, as it was referred to by the Tax Court), the capital of which was furnished by the Barenfeld-Glaser Group and of which Berger was president and prime mover. Its purpose was to subdivide and develop land and construct homes thereon. Neither Freeland nor petitioner was an officer, director, stockholder or investor in LMDC. [TC 9.]

On November 4, 1954, LMDC purchased 3.19 acres by a partial exercise of its 500-acre option and constructed 7 model homes thereon. It also installed the off-site improvements. [TC 14.] In July and August

1955, LMDC purchased an additional 146.93 acres in partial exercise of its option. [TC 16.] LMDC constructed a total of 196 homes. [TC 17.]

The Tax Court found as follows:

1. "In December 1954 or January 1955, a series of disputes arose between SBIC and LMDC." [TC 16.]
2. "... By the summer of 1955, LMDC developed financial difficulties." [TC 17.]
3. "Ultimately, LMDC was unable to overcome its financial difficulties. It became insolvent on May 4, 1965. LMDC assigned to Phoenix Insurance Company of Hartford all of its assets, except that it retained the right under the amended option agreement to purchase 200 acres of land out of the 500 acres originally covered by the option. Since LMDC had already exercised its option to the extent of approximately 150 acres, the portion of the option assigned to Phoenix only covered the right to purchase the remaining approximately 150 acres. Phoenix subsequently exercised this option." [TC 17-18.]
4. "Berger was blamed for mismanagement of LMDC and was himself in financial difficulty." [TC 18.]

Carlos Tavares, one of the most successful land developers in the San Diego area, hearing of Berger's financial difficulties, offered to purchase Berger's partnership interest. On August 10, 1956, Berger sold to Tavares his partnership interest in SBIC, together with the interests of the HAB Trust and the MPB Trust, a total of 40 percent interest in the SBIC partnership,

for \$950,000.00. Berger did not obtain Freeland's consent to such sale, as required by the SBIC partnership agreement. [TC 18.]

Tavares then approached Freeland in an effort to have him join in development of the land, which Freeland refused. Tavares then sought to purchase Freeland's and petitioner's interests. Finally, on or about November 26, 1956, Freeland and petitioner sold their partnership interests in SBIC to Tavares. [TC 18.]

The SBIC partnership never purchased any real property other than the 4,500 acre Waring Ranch. Its only sales of real property were the 150 acres to LMDC and 150 acres to Phoenix Insurance Company, both under the 500-acre option, granted at the time SBIC acquired the property, the sale of a fractional acre to the telephone company, and the sale of 4 acres to the City of San Diego for a reservoir site as required by the seller when SBIC purchased the land. [TC 20.]

The Tax Court specifically found:

1. "Freeland did not wish directly to engage in subdividing and developing the land, either individually or through any other business form, because it would place him in competition with his clients and those of his engineering partnership and thus be financially injurious." [TC 19.]
2. "At no time material hereto was either Freeland or Lowthian individually a dealer in real estate or individually holding real estate for sale to customers in the ordinary course of business." [TC 19.]
3. "... SBIC itself never directly advertised, promoted, or otherwise engaged in active efforts to

solicit for its land, nor did it authorize anyone to undertake such activities directly on its behalf.” [TC 19.]

Notwithstanding all the foregoing, the Tax Court made a so-called ultimate finding, that SBIC held the land in question primarily for sale to customers in the ordinary course of its trade or business. [TC 21.]

The taxes reported on the 1956 returns of Freeland and petitioner Lowthian were \$59,582.95 and \$4,085.34, respectively. The deficiencies for the year 1956 were \$93,332.32 and \$10,231.29, respectively, the major portion of such deficiencies being attributable to the gain from the sales at issue in this case. [TC 20.]

During 1957, Internal Revenue Agent George Colling was assigned to audit the 1956 returns of Freeland and Lowthian. Colling specifically questioned the propriety of capital gain treatment of the sale of their respective interests in SBIC. SBIC’s books and records were examined, as were many official city records. Colling concluded that Freeland and Lowthian correctly reported the gain from the sale of their respective partnership interests as capital gain. On September 19, 1958, the District Director of Internal Revenue sent letters to Freeland and Lowthian accepting their 1956 returns, subject to adjustments not material herein. [TC 21.]

On April 26, 1962, the District director approved the re-opening of petitioner’s 1956 year “due to the amount of money involved and in the interest of being consistent” with the cases of the other partners in SBIC handled by another agent. On July 29, 1964, respondent issued his statutory notices herein asserting that

the sale of the partnership interests resulted in ordinary income. The period of limitations had been extended beyond that date by appropriate consents executed by Freeland and Lowthian. [TC 21.]

Specification of Errors.

1. The Tax Court erred in its conclusion that the plans of SBIC at the time of acquisition of its property continued to govern its subsequent activities, and in its conclusion that there was no change in purpose in the holding of its property. Such conclusions are not supported by its findings, but are contrary to its findings, are without support in the evidence, and are clearly erroneous.

2. The Tax Court erred in applying an erroneous legal concept in finding or concluding that SBIC held property primarily for sale to customers in the ordinary course of trade or business because of alleged “concealed participation” of some of the SBIC partners through a screen and because of alleged “interlocking participation” of some of the partners of SBIC with LMDC.

(a) If there ever had been any “concealed participation” or “interlocking participation” such participation had completely disintegrated and ceased to exist long prior to the sale of petitioner’s limited partnership interest in SBIC.

(b) Insofar as petitioner Margaret C. Lowthian is concerned, there never was and never had been any “concealed participation” or “interlocking participation” by her in any other organization, and hence in any event the Tax Court’s legal concept could have no application to petitioner Margaret C. Lowthian.

3. The Tax Court erred in holding that the property of SBIC was held primarily for sale to customers at the time petitioner sold her partnership interest in SBIC.

4. The Tax Court erred in imputing to petitioner Margaret C. Lowthian the intentions of others, and in refusing to follow the decision of this Honorable Court in *United States v. Rosebrook* (C.A. 9, 1963), 318 F. 2d 316.

5. The Respondent abused his administrative discretion in reopening petitioner's income tax return for 1956 after it had been audited and accepted as filed.

Summary of Argument.

I. In deciding this case the Tax Court ignored the "normal criteria" generally used as tests in cases involving the present issue, such as frequency and continuity of sales, advertising, solicitation, development, etc. SBIC did none of these things; and in fact made no sales during the more than two years it held the property, other than the two sales under the option already in existence when it acquired the land. Although conceding that SBIC did not intend to develop the land itself, the Tax Court develops what seems to be a new legal concept, of imputing a motive to the partnership based upon alleged "concealed participation" or "interlocking relationships." Petitioner submits that such concept is without merit; it fails to establish the fact that *the partnership* held the raw land for sale to customers in the ordinary course of *its* trade or business, which is the crucial question here; indeed it fails to establish that the *partnership itself* was ever in any such business, the evidence and the Tax Court's findings re-

vealing that it was not. Moreover, if such “concealed participation” did exist at the beginning, the plans had completely disintegrated long prior to the sales of partnership interests in question here, and were not germane to the purpose of the holding at the time of the sales. And, finally, there was no such “concealed participation” or “interlocking relationships” insofar as petitioner Margaret C. Lowthian was concerned, at any time.

II. The Commissioner abused his discretion under his own Revenue Procedure, when he reopened petitioner’s 1956 income tax return audit. The interpretation of such Revenue Procedure adopted by the Tax Court is a strained and unreasonable one, which would practically deprive the administrative policy of any meaning or effect for taxpayers in general.

ARGUMENT.

I.

The Tax Court Refused to Apply the Normal Criteria in Deciding This Case, and Its Conclusion That the Property Was Held Primarily for Sale to Customers in the Ordinary Course of Trade or Business Is Clearly Erroneous.

The Tax Court decided this case by ignoring the “normal criteria” usually applied in determining whether real property is or is not held primarily for sale to customers in the ordinary course of trade or business. These “normal criteria” are the frequency and continuity of sales, the soliciting of sales, advertising, improving or developing the property for sale, etc.

The partnership SBIC did absolutely none of these things.

Instead, the Tax Court sought to construct a pattern of “concealed participation” or “indirect” involvement, or “interlocking relationship.” Thus, we quote from its own findings and opinion:

“The normal criteria are not the exclusive benchmarks for decision in a case such as this, where there were good reasons for indirect as opposed to direct participation in development activities and where the period of gestation was prematurely cut short.” [TC 33.]

“Freeland’s unwillingness to join Tavares in active development does no more than confirm his unwillingness to engage in *open* competition with clients of his engineering partnership. It does not operate to erase a pattern of *concealed* participation in development through an appropriate screen such as LMBC.” [TC 28.]

“We think it clear that SBIC did not itself intend to develop the 4,500 acres—such action would have been damaging to Freeland’s professional activities and those of his engineering partnership.” [TC 26.]

“We think the answer to the question of the role which SBIC or its principal partners was to play in development lies in the plans and operations of LMDC and its arrangements with SBIC.” [TC 29.]

“It is apparent to us, however, that Berger and the Barenfeld-Glaser Group, all of whom were partners in SBIC, had substantial interests in LMDC although the precise extent of these interests was never established. These interlocking participations provided the real guarantee that the option would be exercised.” [TC 29-30.]

“In this connection, we note that, while Freeland did not have an ownership participation in LMDC, he could reap his financial reward from that entity via direct personal engineering fees and fees paid to his engineering partnership.” [TC 31.]

Thus, it is crystal clear that the Tax Court did not really decide that the partnership SBIC held its property primarily for sale to customers in the ordinary course of trade or business. Its findings repudiate any such conclusion. What the Court really decided was that since certain of its partners were also interested in and would benefit from the development of the properties by another entity, the partnership should be deemed to have a purpose which it really did not have. This, we submit, is a wholly erroneous interpretation of the statute.

It is understandable why the income derived by a merchant from the day-to-day sale of his inventory or stock in trade should be taxed as ordinary income. It is ordinary income. But certainly that is a far cry from the acquisition of a parcel of raw land by a partnership, which makes not a single sale except under an option existing when it acquired the land, which holds the land for more than two years and makes no development or attempt to make any sales, and which in fact rejects all offers to buy.

It is inconceivable that a partnership could be held to hold property primarily for sale to customers in the ordinary course of its trade or business where it makes no such sale in a two-year period. But, as we have said, the Tax Court really did not so hold. It was looking to a so-called “interlocking” relationship with LMDC.

The significant fact is that, even assuming such “interlocking” relation existed at the outset, it had completely disintegrated and ceased to exist long before the sale of petitioner’s partnership interest. LMDC had been a complete financial failure and had gone out of business. In financial straits, Berger had then sold his and related 40 percent interests in the SBIC partnership.

What, then, was the purpose for which SBIC held its property?

Tavares wanted to develop the property. Freeland refused.

In that posture, how can it possibly be concluded that the property of SBIC was held primarily for sale to customers in the ordinary course of trade or business? The answer, we submit, is obvious. It simply was not so held.

Having come to an impasse, the solution was to liquidate the investment—which is exactly what petitioner and Freeland did by selling their partnership interests. But this was a liquidation of their investment, not profit attributable to the day-to-day operation of merchants trading in inventory or stock in trade.

The most recent case in which this Court has been called upon to reverse the Tax Court for failure to apply the proper legal concepts in deciding whether real property is held for sale to customers in the ordinary course of trade or business is *Joan E. Heller Trust v. Comm.* (C.A. 9, August 25, 1967), F. 2d, in which this Court gave expression to the principles announced by the United States Supreme Court in *Malat v. Riddell*, 383 U.S. 569, 86 S. Ct. 1030, 16 L. Ed. 2d 102, quoting from its opinion as follows:

“The purpose of the statutory provision with which we deal is to differentiate between the ‘profits and losses arising from the everyday operation of a business’ on the one hand (*Corn Products Refining Co. v. Commissioner of Internal Revenue*, 350 U.S. 46, 52, 76 S. Ct. 20, 24, 100 L. Ed. 29) and the ‘realization of appreciation in value accrued over a substantial period of time’ on the other. (*Commissioner of Internal Revenue v. Gillette Motor Transport, Inc.*, 364 U.S. 130, 134, 80 S. Ct. 1497, 1500, 4 L. Ed. 2d 1617).”

The findings of the Tax Court [TC 4] and the deposition of Tavares (Document No. 33, p. 14) are conclusive that the profit realized by petitioner upon the sale of her partnership interest was attributable to appreciation in the value of the San Diego land—and not to any day-to-day dealing in real estate.

II.

Petitioner Margaret C. Lowthian Was Not a Party to Any Concealed Participation or Interlocking Relationship and Hence Any Imputation of Motive to Her Was Erroneous.

Despite all the foregoing, it is abundantly clear that as to petitioner Margaret C. Lowthian there was no “concealed participation” or “interlocking participation” and hence any imputation of motives is entirely unwarranted. In this respect the case is similar to *United States v. Rosebrook* (C.A. 9, 1963), 318 F. 2d 316.

In that case the taxpayer, by and through her father, had acquired an undivided one percent interest in a tract of land on the San Francisco peninsula, which interest had been committed to a joint venture for development by a corporate entity. The principal joint venturers were interested in a development company to which the land was sold. The Internal Revenue Service insisted that the purpose of the other joint venturers must be attributed to her, as a matter of law. But this Court held to the contrary, saying:

“* * * The able District Judge in a well-reasoned opinion pointed out that not all participants in a joint venture need have the same intent and purpose. * * *”

* * *

“We do not believe that the making of an investment by a trustee in a joint venture irrevocably imputes to the beneficiary of the trust the intentions of the managers of the venture regardless of when the trust property is removed from the venture.”

We respectfully submit that in the present case there is no evidence whatsoever of any participation by petitioner Margaret C. Lowthian in any "concealed participation" or "interlocking participation" with any other entity. Hence, as to her there is no basis whatever for the Tax Court's conclusion. She simply had an investment as a limited partner in the SBIC partnership which, itself, did not hold property primarily for sale to customers in the ordinary course of its trade or business. She merely sold her interest in that partnership.

Her gain upon the sale of her partnership interest was accordingly a capital gain.

III.

The Respondent Abused His Administrative Discretion in Re-Opening Petitioner's Income Tax Return for 1956 After It Had Been Audited and Accepted as Filed.

Petitioners' 1956 years were apparently re-opened by respondent under the authority of Rev. Proc. 59-25, 1959-2 C.B. 938, which states, in part:

"It is the administrative practice of the Internal Revenue Service not to reopen cases previously closed by the District Director unless there has been substantial error, both in amount and in relation to the total tax liability, or there is evidence of fraud, malfeasance, collusion, concealment or the misrepresentation of a material fact."

Respondent has never indicated that the ground for re-opening these cases was either fraud, malfeasance, collusion, concealment or the misrepresentation of a material fact, and the Tax Court held that none of these

was present. [TC 36.] Hence, the ground for re-opening under Rev. Proc. 59-25 must be "substantial error."

The Revenue Agent who audited petitioner's 1956 year was possessed of all the facts, documents, and other data he needed to make his determination. Thereafter, on September 19, 1958, the District Director sustained his judgment and closed petitioner's 1956 year. At no time during the trial of these cases did respondent introduce any evidence that had not been considered by the Revenue Agent during the course of his audit of petitioner's 1956 returns.

As a result of having re-opened petitioner's 1956 year, petitioners have been subject to the stress and expense of defending themselves against the assertion of large deficiencies from a transaction that was clearly a capital gain in 1956 and which respondent accepted as such in 1958. Additionally, respondent's dilatory processing of these cases has subjected petitioners to the burden of paying the tremendous interest on the asserted deficiencies, some 60 percent for the re-opened year of the transaction in issue.

For these reasons we submit that respondent abused his discretion under Rev. Proc. 59-25 by re-opening petitioner's 1956 year.

The Tax Court held that "substantial error" has reference only to the dollar amounts involved. This, we submit, is an erroneous interpretation. The crucial word, in petitioner's view, is the word "error." On most income tax returns of any complexity there may easily be items upon which opinions or judgments of individual Agents or Reviewers might conceivably vary. The instant case is an example in point. The first

Agent was of the opinion that the transaction was correctly reported as capital gain. The second Agent took the opposite view. Under the Tax Court's determination every return would be subject to re-opening just depending upon different opinions of Agents as long as the dollar amount was substantial enough.

This, we submit, would be a meaningless policy or administrative practice, and would afford slight repose to taxpayers generally.

We submit that the correct interpretation is that in cases of an admitted error—such as an inadvertent omission of an item of income or the claiming of a deduction in error—such cases may be re-opened if they are substantial both in amount and in relation to the total tax liability.

Conclusion.

The Tax Court's decision should accordingly be reversed.

Respectfully submitted,

ADAM Y. BENNION,
CHARLES E. BURCH, JR.,
JOHN B. GREGORY,
Attorneys for Petitioner.

Certificate.

I certify that, in the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

ADAM Y. BENNION

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MARGARET C. LOWTHIAN,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE
TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

FILED

DEC 7 1967

WM. B. LUCK, CLERK

MITCHELL ROGOVIN,
Assistant Attorney General.

LEE A. JACKSON,
DAVID O. WALTER,
MARCO S. SONNENSCHN,
Attorneys,
Department of Justice,
Washington, D. C. 20530.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 21795-A

MARGARET C. LOWTHIAN,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE
TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court
(I-R. 114-151), ^{1/} are not officially reported.

^{1/} "I-R." references are to Volume I of the record on appeal.
"II-R." references are to Volume II of the record on appeal.

JURISDICTION

The petition for review (I-R. 168-174) involves deficiencies in federal income tax for the taxable years 1956, 1957, 1958 and 1960 in the amount of \$38,763.01. On July 29, 1964, the Commissioner of Internal Revenue mailed to the taxpayer a notice of deficiency asserting deficiencies in tax for the years 1956, 1957, 1958 and 1960 totaling \$38,763.01. (I-R. 21-29.) Within ninety days thereafter, on October 19, 1964, the taxpayer filed a petition with the Tax Court for a redetermination of these deficiencies under the provisions of Section 6213 of the Internal Revenue Code of 1954. (I-R. 13-29.) The decision of the Tax Court was entered December 30, 1966. (I-R. 153.) The case is brought to this Court by a petition for review filed March 29, 1967 (I-R. 168-174), within the three-month period prescribed in Section 7483 of the Internal Revenue Code of 1954. Jurisdiction is conferred on this Court by Section 7482 of that Code.

QUESTIONS PRESENTED

1. Whether the Tax Court was correct in deciding that a partnership had been holding land for sale to customers in the ordinary course of its trade or business.
2. Whether the Tax Court was correct in deciding that the Commissioner had not abused his administrative discretion in reopening taxpayer's income tax return which had been previously audited.

STATUTES AND OTHER AUTHORITY INVOLVED

The pertinent provisions of the statutes involved and Revenue Procedure are set out in Appendix, infra.

STATEMENT

The facts relevant to this appeal, as found by the Tax Court (I-R. 115-134), some of which were stipulated, are substantially as follows:

Taxpayer is a single woman. She resides in San Diego County, California, and filed her tax returns for the years in question with the District Director of Internal Revenue at Los Angeles, California. (I-R. 115-116.)

From 1923 through the time of trial, Freeland^{2/} has been a full time civil and structural engineer living and working in San Diego County, California. He is licensed to practice by California and certain other states and has been and continues to be a member of

^{2/} In the Tax Court, this case was consolidated with that of Estate of Eugene L. Freeland, Deceased, by Security First National Bank, a national banking association, Executor, and Vera Good Freeland, by L. N. Turrentine, Conservator. The Tax Court stated (I-R. 116):

At all times material Lowthian was Freeland's secretary and business associate. Her participation in the transactions involved herein was through and with Freeland. The tax treatment accorded to Freeland will control with respect to the tax treatment of the transactions as far as Lowthian is concerned.

Accordingly, although separate appeals have been taken by Freeland (No. 21795) and Lowthian, the facts relevant to Lowthian's case will deal essentially with Freeland's activities. True, taxpayer urges (Br. 17-18) that this is error, but we will reply to this contention in the Argument portion of our brief.

numerous professional engineering associations and societies. During the years involved herein, he was a senior member of a civil engineering firm and a structural engineering firm. (I-R. 116.)

Freeland's practice has included land surveying, the design of municipal improvements, the subdivision of land, and the design of buildings and structures. He rendered professional services in some of the larger real estate developments in the San Diego area and included among his clients some of the area's most active real estate subdividers and developers. Because of the rapid growth of San Diego County prior to and during the years in question, and because of his excellent reputation, Freeland's practice has been financially successful. The growth of San Diego County has also resulted in a continuing and substantial appreciation in real estate values. (I-R. 116-117.)

Among the many land developers employing Freeland and/or his civil engineering firm (hereafter referred to as the "engineering partnership") were George T. Forbes and Theodore M. Jacobs, doing business as Kensington Heights Company. In the late 1940's and again in 1951 and 1953, the engineering partnership rendered services to Kensington with respect to the so-called Waring Ranch property in the form of surveying the land, preparing boundary, topographical and master plan maps thereof, and representation before the City of San Diego Planning Commission and other city departments in its efforts to have the land annexed to the City of San Diego so as to make it more salable. Four hundred acres were annexed in 1951 and subsequently

sold by Kensington. An additional 1,300 acres were annexed in 1952 or 1953 and sold by Kensington to Bollenbacher & Kelton, Inc., subdividers and developers. The engineering partnership was then employed by Bollenbacher & Kelton, Inc., to do the engineering work on the subdivision and development of the 1,300 acres. (I-R. 117.)

In 1953, efforts were made by Kensington to have the City of San Diego annex the remaining 4,500 acres. At the time of the annexation proceedings, the engineering partnership prepared a master plan map of the area, which indicated the lines along which development might feasibly proceed. The City of San Diego annexed the 4,500 acres in December of 1953. The 4,500 acres contained a lake, some canyons, and a mountain rising about 1,100 feet above the surrounding terrain. (I-R. 118.)

Shortly before the annexation, Kensington sought Freeland's help in finding a buyer for the 4,500 acres. Freeland contacted several clients who were not interested because they thought that development and subdivision of the area was too remote in time. (I-R. 118.)

In April, 1954, Kensington gave Freeland a verbal option on the land. Freeland and one of his developer-clients, Sam Berger, decided to form a partnership to purchase the land. On August 6, 1954, they entered into an agreement to form the partnership, the terms of which were to be reduced to writing in the near future. Under the agreement, Berger was to enter into an escrow in his own name for the purchase of the land from Kensington. Before the close of the escrow, Berger was to nominate the partnership to take title to the land. (I-R. 118.)

Berger negotiated the terms for the purchase with Kensington. In the course of the discussions, Berger indicated that the whole 4,500 acres would be developed as soon as possible and that he had \$20,000,000 in financing available, which was not in fact the case. Berger also told Kensington that the purchase price would be paid off in about three years. (I-R. 118-119.)

On August 6, 1954, Berger entered into an escrow agreement with Kensington. The agreement provided for a total consideration of \$4,676,666.66 (computed on the basis of \$800 per acre plus interest at 3 1/3 percent), payable \$100,00 down and the balance in 20 annual installments. The purchase price was to be evidenced by an installment promissory note, the first installment of \$180,000 to become due on August 6, 1955, with the remaining installments due annually thereafter in increasing annual amounts of \$6,000 until the 19th installment in the amount of \$288,000. The 20th and final installment was to be the remaining balance of \$130,666.66. The escrow agreement contained provisions for the release of 150 acres against each annual payment, for the privilege of prepayments with appropriate adjustments for interest, and for the deposit by the purchaser of \$200,000 to be disbursed for off-site improvements upon instructions from Kensington. (I-R. 119.)

The term "off-site improvements" comprehended two things: (1) the bringing of utilities, viz., water, sewer, gas, electricity, and telephone, from a point distant from the boundaries of the property being developed up to the boundaries of such property; and (2) the

installation of a utility, e.g., a water main, on the property being developed, which utility is larger than required to serve such property but which is nevertheless required by the City of San Diego in order to be available to serve further outlying property in the path of future development. With regard to these latter "off-site improvements," the city generally paid the difference between what the property being developed required and what the city insisted upon for purposes of future property development. (I-R. 119-120.)

Freeland provided \$70,000 towards the \$100,000 down payment. Berger borrowed the other \$30,000 with Freeland acting as guarantor of the loan. (I-R. 120.)

In the process of trying to raise the \$200,000 deposit, Freeland contacted the General Petroleum Corporation, seeking a loan. As part of the attempt to borrow the funds, a letter was sent on September 14, 1954, over Freeland's signature, but without identification as to the capacity in which he was signing, to General Petroleum Corporation's representative in San Diego. The letter proposed that the corporation lend the necessary funds in exchange for exclusive service station sites within the contemplated 4,500-acre development. The letter also stated that a master plan for the development of the entire 4,500 acres was being completed and that it was proposed to start immediately the development of approximately 2,000 homes. The letter further stated that it was anticipated that a minimum of 4,000 homes would be constructed and occupied within three years and that, after the points involving financing the off-site improvements, completing the master

plan, and selecting the location of the first 2,000 homes had been settled, consideration would be given to the sale of acreage to subdividers capable of proceeding with the development in a satisfactory fashion. After due consideration, General Petroleum declined to provide any funds. (I-R. 120-121.)

After several unsuccessful attempts to raise the \$200,000 from various other sources, Berger's associates in a development operation consisting of a joint venture of several corporations, known as "Country Club Park" (for which Freeland individually acted as a consultant before various governmental agencies), agreed to put up the \$200,000 for the off-site improvements. In return, this group (hereafter referred to as the "Barenfeld-Glaser Group") received a 20 percent interest in the Berger-Freeland partnership. (I-R. 121.)

On October 21, 1954, the Lake Murray Development Company, a California corporation (hereinafter referred to as "LMDC"), was incorporated for the purpose of subdividing and developing land and constructing homes thereon. LMDC was capitalized with funds that were advanced by the Barenfeld-Glaser Group. The stock of LMDC was held by Herbert Glaser, an attorney, as trustee for the benefit of the corporations which comprised the Country Club Park joint venture. Berger was the initial president of LMDC and Herbert Glaser was its secretary and attorney. Neither Freeland nor Lowthian was an officer, director, stockholder, or investor in LMDC. Other principals included Sam Glaser, the father of Herbert, and Jack Barenfeld. (I-R. 121-122.)

Shortly after October 21, 1954, but prior to October 26, 1954, Sam Glaser and Jack Barenfeld caused \$200,000 to be advanced by the Country Club Park joint venture to LMDC and thence from LMDC to the Berger-Freeland partnership, Sam Berger Investment Company (hereinafter referred to as "SBIC"). On October 25, 1954, SBIC caused the \$200,000 to be deposited in the escrow covering the purchase of the 4,500 acres. On October 26, 1954, the escrow was closed and title in the land was vested in SBIC subject to a deed of trust for the unpaid purchase price. (I-R. 122.)

On or about October 26, 1954, SBIC and LMDC entered into an option agreement, which was subsequently reduced to writing and executed on November 23, 1954. Partial consideration for this option was the fact that Sam Glaser and Jack Barenfeld had caused LMDC to provide the \$200,000 to SBIC to enable it to close the escrow. The agreement gave LMDC an option to purchase 500 acres of land lying within a larger parcel of approximately 800 acres in the southeast corner of the property for a price of \$2,000 per acre. (I-R. 122.) The option agreement further provided in pertinent part (I-R. 122-123):

(a) That SBIC was to release from the Kensington escrow a minimum number of acres per year in order to prevent a lapse of its right to continue to release acreage.

(b) That if LMDC purchased less than 150 acres per year under its option, SBIC had the right to sell the unpurchased difference.

(c) That LMDC realized that SBIC had an oral arrangement with "other subdividers" to purchase portions of the 800-acre parcel within

which the 500 acres subject to the option was encompassed.

(d) That SBIC would cooperate with LMDC in filing the necessary maps and in expeditiously completing the building lots.

(e) That LMDC would submit to SBIC all its contracts with subcontractors for all items of work so as to guarantee that the cost would not exceed a certain minimum.

(f) That LMDC should be reimbursed by SBIC for expenses in excess of the stipulated maximum per lot cost of development, and SBIC would retain, as profit, any funds remaining in the trust fund established for lot development.

(g) That SBIC would be liable for all off-site improvement costs in excess of the \$20,000 originally advanced by LMDC.

On November 23, 1954, the date on which the option agreement between SBIC and LMDC was signed, a formal limited partnership agreement was also executed by all of the general and limited partners in SBIC. This agreement was effective as of August 6, 1954. Under the terms of the agreement, Freeland, with a 32 percent interest, and Berger, with a 20 percent interest, were the general partners. Lowthian with an 8 percent interest, was Freeland's designee and was a limited partner. The HAB Trust and the MLB Trust, each with a 10 percent interest, were Berger's designees and were limited partners. The final 20 percent was a limited partnership interest held under the name of Lake Murray Trust No. 1. The interests of the HAB Trust and the MLB Trust in SBIC were created by Sam Berger for his two sons, Harvey A. Berger and Marshall L. Berger. Sam Berger was the sole trustee of the

HAB Trust and the MLB Trust. Neither the beneficiaries of these trusts, Harvey A. Berger and Marshall L. Berger, nor the trusts themselves held any interest in LMDC. The 20 percent interest in SBIC, held under the name of Lake Murray Trust No. 1, was established for the benefit of Jack Barenfeld and Samuel Glaser. At a later date, Barenfeld and Glaser gave 10 percent of their interest in this trust to the other members of the Barenfeld-Glaser group. (I-R. 123-124.)

The preamble to the SBIC partnership agreement provided that the purpose of the partnership was to engage "in the business of buying, selling and developing land upon the real property commonly known as the Third Annexation of the Waring Property consisting of approximately four thousand five hundred (4500) acres of land in the City of San Diego, State of California." (I-R. 125.)

The body of the agreement provided, inter alia (I-R. 125-126):

(a) That the term of the partnership would be 10 years.

(b) That each partner, general or limited, was prohibited from selling, assigning, or transferring his interest in the partnership to any person other than another partner but that the agreement would subsequently be amended to resolve the question of the withdrawal or sale by the partners of a partnership interest.

(c) That Freeland and Berger were to contribute \$70,000 and \$30,000, respectively, to the partnership but further that they could withdraw said sums from the first monies available to the partnership.

(d) The general business policy of said partnership in all questions relating to the management of its business should be determined by the mutual consent of the general partners.

(e) Both general partners were to have full management rights and control.

(f) Freeland was to receive an engineering fee of \$25 per lot (in addition to any other engineering fees) from the first 2,000 lots "developed or sold by the partnership to third parties."

(g) That in the event the general partners could not agree, the problem would be submitted to arbitration.

After the closing of the Kensington escrow on October 26, 1954, Berger was anxious to get LMDC activated. The engineering partners and Freeland, as consulting engineer for LMDC, commenced applying for the necessary permits and talking with various city departments in order to get necessary city approval. Freeland's engineering partner was also employed by LMDC and performed various services for LMDC relating to on-site development and off-site improvements. (I-R. 12)

On November 8, 1954, Freeland forwarded to the San Diego Planning Commission on behalf of LMDC a "Tentative Map Unit No. 1 [Lake Park Development Property]." Unit No. 1 consisted of approximately 30 acres to be subdivided into approximately 260-280 lots. Submitted at the same time were ten copies of a master plan map for the entire 4,500 acres and ten copies of a master plan map of the 800 acres submitted to LMDC's 500-acre option. The master plan map of the 4,500 acres was an identical copy of that prepared for Kensington and Mrs. Waring on October 23, 1953, except that a portion of the lower right-hand section of that map had been cut out and a new section representing Unit No. 1 inserted. The map for the 4,500 acres indicated tentative locations for schools, parks, and supermarkets for the entire tract. It showed

that, when fully developed, the 4,500 acres would yield an estimated 16,000 lots. As a result of discussions with representatives of SBIC and LMDC concerning approval of the subdivision plan, the representatives of the San Diego Planning Commission understood that Unit No. 1 was the first unit in a planned development that would ultimately total 4,500 acres. (I-R. 126-127.)

On November 4, 1954, LMDC purchased 3.19 acres by a partial exercise of its 500-acre option. LMDC then commenced construction of seven model homes on this acreage. It was necessary for LMDC to bring off-site improvements to the Lake Park Property's southeast border in order to develop this acreage. In late December, 1954, the seven model homes were completed and opened to the public for inspection. The advertising campaign referred to a "City of Tomorrow" to be developed on the 4,500 acres. Freeland, though he was aware of such advertising, disapproved of it and so informed Berger. (I-R. 127.)

On December 14, 1954, the City Council, on the recommendation of the Planning Commission, gave preliminary approval to the subdivision plan for Unit No. 1. Prior to December 23, 1956, LMDC, through its agent Freeland, submitted to the City Planning Department a tentative subdivision map for Units Nos. 2 and 3. Prior to January 17, 1955, LMDC similarly submitted a tentative subdivision map for Units Nos. 4 and 5. The size of the lots ranged between one-fourth of an acre and one-fifth of an acre. It was anticipated that 500 acres would produce between 2,200 and 2,400 lots. Units Nos. 1 through 5, if fully developed, would contain a total of approximately 3,000 lots and

covered the 800-acre parcel on which LMDC had a 500-acre option.
(I-R. 127-128.)

The city, in considering a tentative subdivision plan, was concerned, inter alia, with the location and adequacy of schools, parks, shopping centers, and off-site improvements, including adequate water supply. Though an immediate proposal might concern only a very small number of acres, the city considered the development in terms of overall plans for the surrounding area. The city would not permit wasteful duplication of facilities such as two small water reservoirs where one larger reservoir would be considerably more economical.
(I-R. 128.)

Both Berger and Freeland represented SBIC in negotiations with the San Diego Unified School District pertaining to the granting of options for school sites within Units 1 through 5. (I-R. 128.)

On March 8, 1955, SBIC, through a letter signed by Berger, offered the School District school sites at a price equal to \$2,000 per acre plus "the average off-site cost for the entire 4,500 acres of approximately \$200 per acre," plus the cost of on-site improvements. Additional land for park and recreational purposes was offered on the same terms. This offer was not accepted by the School District. On September 23, 1955, SBIC, through a letter signed by Berger, offered the School District, for \$1 each, options on school sites within Units 1 through 5 at \$1,900 per acre for usable land. SBIC also agreed to give the School District renewable options on specific sites of land selected by the School District on the remaining areas to be developed by SBIC. (I-R. 128-129.)

On July 26, 1955, the San Diego City Council adopted the Final Subdivision Map of College Ranch Unit No. 1, which map was filed and recorded in the County Recorder's Office on July 27, 1955. In July and August of 1955, LMDC partially exercised its 500-acre option and purchased an additional 146.93 acres from SBIC. LMDC then commenced development of Unit No. 1. LMDC also commenced the off-site improvement work for the 500-acre development. The principal aim in construction of these facilities was to provide adequate facilities for the 500 acres with minimum damage to the remaining 4,000 acres. (I-R. 129.)

In December, 1954, or January, 1955, a series of disputes arose between SBIC and LMDC. As a result of these disputes, LMDC and SBIC entered into an amended option agreement covering the 500 acres. The purchase price of the land was changed to \$2,000 per acre for the first 250 acres and \$1,800 per acre for all additional acreage. The "loan" of \$200,000 by LMDC to SBIC was labelled a "credit," with LMDC entitled to recover any portion not used for off-site improvements, and no interest would be paid on the credit. LMDC's prior oral agreement to pay Freeland \$25 per lot for his personal service and counsel was reduced to writing. The agreement also eliminated the lot and off-site improvement cost guarantees by SBIC. (I-R. 129-130.)

LMDC engaged in the construction of 196 homes. By the summer of 1955, LMDC developed financial difficulties. In an attempt to remedy the situation, Berger sought a change in the amended option agreement permitting LMDC to acquire what he thought would be more

salable land. He proposed to develop land in the foothills of the mountain which would have a view of the lake. Employees of the engineering partnership prepared a feasibility study of the proposal, the conclusion of which was that the cost of off-site improvements would be prohibitive at that time. (I-R. 130.)

Ultimately, LMDC was unable to overcome its financial difficulties. It became insolvent on May 4, 1956. LMDC assigned to Phoenix Insurance Company of Hartford all of its assets, except that it retained the right under the amended option agreement to purchase 200 acres of land out of the 500 acres originally covered by the option. Since LMDC had already exercised its option to the extent of approximately 150 acres, the portion of the option assigned to Phoenix only covered the right to purchase the remaining approximately 150 acres. Phoenix subsequently exercised this option. (I-R. 130-131.)

Berger was blamed for mismanagement of LMDC and was himself in financial difficulty. In August, 1956, Carlos Tavares, representing a group of developers, including himself, approached Berger and offered to purchase his interest in SBIC. Tavares had been one of the developers approached by Freeland at the time of the annexation of the 4,500 acres. (I-R. 131.)

On August 10, 1956, the Tavares group agreed to buy out Berger's interest and the respective 10 percent interests of the HAB Trust and the MLB Trust in SBIC for \$950,000. Berger did not get Freeland's consent for the sale of his interest in SBIC as required by the partnership agreement. (I-R. 131.)

Tavares then approached Freeland in an effort to purchase his interest in SBIC or, in the alternative, to have Freeland join the Tavares group in the development of the SBIC land. Freeland told Tavares he was not interested in joining in the development and decided to sell out. Lowthian decided to sell out her interest as well. Freeland received \$730,000 for his interest, while Lowthian received \$220,000 for hers. In the agreement of sale, they consented to the purchase from Berger. (I-R. 131.)

During the taxable periods portions of the acreage were utilized for grazing and the raising of barley. The partnership reported gross income from these sources in 1955 of \$10,467.99 against total expenses of \$27,609.92 (of which \$15,319.51 represented real estate taxes) and in 1956 of \$17,958.50 against total expenses of \$45,032.69 (of which real estate taxes represented \$15,619.01). (I-R. 132.)

Freeland did not wish directly to engage in subdividing and developing the land, either individually or through any other business form, because it would place him in competition with his clients and those of his engineering partnership and thus be financially injurious. (I-R. 132.)

At no time material hereto was either Freeland or Lowthian individually a dealer in real estate or individually holding real estate for sale to customers in the ordinary course of business. (I-R. 132.)

Although no improvements were made directly to the acreage not covered by the option to LMDC, the entire tract benefited from the off-site improvements made by LMDC. SBIC itself never directly

advertised, promoted, or otherwise engaged in active efforts to solicit for its land, nor did it authorize anyone to undertake such activities directly on its behalf. (I-R. 132.)

Freeland, on behalf of SBIC, refused several unsolicited offers for the sale of portions of the acreage not covered by the LMDC option. (I-R. 132.)

SBIC never purchased any real property except the 4,500 acres here in issue. The only sales of real property ever made by SBIC, aside from the 300 acres acquired under the 500-acre option to LMDC, were (1) the sale of a fractional acre to the telephone company and (2) the sale of approximately four acres to the City of San Diego for a reservoir site as required by Kensington when SBIC purchased the land. The only other land transactions of SBIC involved the grant to the San Diego School District of options to purchase sites within the area to be developed by LMDC for three elementary schools and one junior high school. SBIC also agreed to grant further similar options to the School District when development proceeded beyond the initial 500 acres. At the time of the annexation of the 4,500 acres, the city had required the then owners to agree to sell school sites within the property, and Kensington passed this obligation along to SBIC. (I-R. 133.)

Lowthian reported gain on her sale of her partnership interest in SBIC on the installment basis as long-term capital gain. (I-R. 133.)

The tax as disclosed on Lowthian's 1956 return was \$4,085.34. The deficiency for 1956 was \$10,231.29, the major portion of which represents the gain from the sale of taxpayer's partnership interest. (I-R. 133.)

During 1957, Internal Revenue Agent George Colling was assigned to audit Lowthian's 1956 return. Colling specifically questioned the propriety of capital gain treatment of the sale of her interest in SBIC. SBIC's books and records were examined, as were many official city records. Colling concluded that Lowthian correctly reported the gain from the sale of her partnership interest as capital gain. On September 19, 1958, the District Director of Internal Revenue sent a letter to Lowthian accepting her 1956 return, subject to adjustments not material herein. (I-R. 134.)

On April 26, 1962, the District Director approved the reopening of Lowthian's 1956 year "due to the amount of money involved and in the interest of being consistent" with the cases of the other partners in SBIC handled by another agent. On July 29, 1964, the Commissioner issued his statutory notice herein asserting that the sale of the partnership interest resulted in ordinary income. The period of limitations had been extended beyond that date by appropriate consents executed by Lowthian. (I-R. 134.)

The Tax Court found (I-R. 134) that SBIC held the land in question primarily for sale to customers in the ordinary course of its trade or business.

The Tax Court held (I-R. 151) that the Commissioner had not abused his discretion in reopening taxpayer's previously audited income tax return and assessing deficiencies in tax.

SUMMARY OF ARGUMENT

Although the sale of a partnership interest at a profit will generally result in capital gains treatment, the Internal Revenue Code provides that if the gain is attributable, in whole or part, to substantially appreciated inventory, then to that extent, the gain will be taxed as ordinary income. The question here is whether the land held by a partnership constituted inventory. Taxpayer contends the land was an investment while the Commissioner contends that the land was primarily held for sale to customers in the ordinary course of the trade or business, i.e., inventory.

When the partnership acquired this undeveloped land, it told the seller that the purchase price would be paid off in 3 years. It appears that the partnership would have had to sell the land in order to meet the annual installments of the purchase price because it had no other resources with which to make such payments. The seller of the land knew that the land would have to be improved before the land could be sold (the lack of improvements had caused the seller difficulty in selling the land) and presumably to insure that such improvements would be made, required that the partnership deposit \$200,000 in escrow for such purpose. However, Freeland testified that the partnership could not have developed the land, for such activity would have put him into open competition with developers in the area who were clients of his engineering firm. To overcome this problem, a corporation was

set up in which neither Freeland nor taxpayer was a stockholder but in which Freeland was a consultant. With the exception of taxpayer and Freeland, all the effective interests in the partnership were held by persons directly involved in the corporation. By virtue of this interlocking relationship, the partnership could insure development, without revealing Freeland's participation, and as development would have progressed, the partnership would have sold the land either to the corporation or to other developers. However, this plan never reached full maturity for after having made improvements to the land, constructing some model homes and advertising them for sale, the corporation became insolvent. Shortly thereafter, one of the two general partners sold his interest to a developer and taxpayer and Freeland then sold their interests to the same developer.

Taxpayer's major contention appears to be that relating the corporation's activities to that of the partnership's is not permitted because neither entity controlled the other. However, we submit that such argument lacks merit because it overlooks the realities of the situation. Contrary to taxpayer's contention, the facts readily reveal the interworking of the two organizations, with the common objective of having the tract developed and sold. The corporation supplied the \$200,000 for off-site improvements and in return, was given an option on 500 acres. The partnership guaranteed to pay all off-site costs in excess of \$200,000. Also, the partnership afterwards offered land to the school board in an apparent effort to enhance the value of the tract. Furthermore, the partnership had to have been assured that the

corporation was going to exercise the option, for it, the partnership, was planning on using the proceeds of such a sale in order to meet the first 5 installments on the purchase price. Equally revealing is that the corporation, although only the owner of 500 acres, advertised its model homes as the forerunner of a City of Tomorrow to be built on the 4,500 acres. Obviously then, both the partnership and the corporation were involved in one project, namely, to have the entire tract developed and sold.

Taxpayer also appears to contend that even if there was at one time a purpose to sell the land, such purpose changed. This argument--which is raised here for the first time--is predicated on the fact that the corporation became insolvent and went out of business. However, this fact hardly requires a conclusion, as taxpayer suggests, that the partnership's purpose automatically changed; it simply means that the partnership's plans for developing the tract and selling the land would not be done with the aid of the corporation. Moreover, the record shows that shortly after the corporation's demise, 80% of the partnership was sold, an unlikely event if the partnership had decided, when the corporation became defunct, to hold the property for investment, i.e., a long period of time.

The question is one of fact and should be reversed only if clearly erroneous. Insofar as there is ample evidence to support the Tax Court's finding that the land was held primarily for sale to customers in the ordinary course of business, it should be affirmed.

Taxpayer also contends that the Commissioner abused his discretion in reopening taxpayer's previously audited income tax return and assessing deficiencies in tax. The Commissioner, based on additional evidence, concluded that his original conclusion as to the tax treatment of the partnership interest was wrong and then, following all the procedures he has determined should be adhered to when a case is to be reopened, assessed deficiencies in tax. Taxpayer does not contest this but urges that a return cannot be reopened where the tax treatment depends on a question of judgment despite the fact that such a limitation is not contained in the Commissioner's statement of when cases will be reopened. We submit that the Tax Court was correct in concluding that there was no abuse of discretion in this instance.

ARGUMENT

I

THE TAX COURT WAS CORRECT IN DECIDING THAT A
PARTNERSHIP HAD BEEN HOLDING LAND FOR SALE TO
CUSTOMERS IN THE ORDINARY COURSE OF ITS TRADE
OR BUSINESS

A. Introduction

On November 26, 1956, taxpayer sold her partnership interest in SBIC. Normally, under the provisions of Section 741 of the Internal Revenue Code of 1954, ^{3/} Appendix, infra, the gain on such a sale would be taxed as capital gain. However, Congress recognized that this provision could be employed by members of a partnership to convert

^{3/} All references are to the 1954 Code, unless otherwise stated.

ordinary income into capital gain. Thus, for example, if instead of selling the inventory directly, i.e., in the course of trade, which would result in the partners having ordinary income, the members sold their partnership interest, then under Section 741, the gain on the latter method would be taxed at the lower capital gains rates. To prevent such an abuse, Congress enacted Section 751, Appendix, infra. This section provides that to the extent that the gain on the sale of the partnership interest is attributable to substantially appreciated inventory, then to that extent, the gain will be taxed as ordinary income. In the instant case, all the parties agree that under the formulas contained in Section 751(d)(1)(A) and (B), the land is substantially appreciated. However, the point in dispute is whether or not the land constituted inventory of the partnership. Inventory is defined (Section 751(d)(2)(A)) as property described in Section 1221(1) and when reference is made to this latter section, it becomes apparent that this case involves a question which has given rise to much litigation: namely, whether property was being held for sale to customers in the ordinary course of taxpayer's trade or business.

In the case at bar, the Tax Court found (I-R. 134) that the land held by SBIC was property held for sale to customers in the ordinary course of its trade or business, i.e., inventory for purposes of Section 751. This being a question of fact, the narrow issue on appeal is whether this finding was "clearly erroneous." Rollingwood Corp. v. Commissioner, 190 F. 2d 263, 265 (C.A. 9th); Richards v. Commissioner, 81 F. 2d 369, 370 (C.A. 9th); Yara

Engineering Corp. v. Commissioner, 344 F. 2d 113 (C.A. 3d); Broughton v. Commissioner, 333 F. 2d 492 (C.A. 6th); Coffey v. United States, 333 F. 2d 945 (C.A. 10th); Tidwell v. Commissioner, 298 F. 2d 864 (C.A. 4th). If not, then, in accordance with the usual standards of review, it is entitled to finality. Commissioner v. Duberstein, 363 U.S. 278.

B. The partnership acquired and held the land primarily for sale to customers in the ordinary course of its trade or business

In determining whether or not property was being primarily held for sale to customers in the course of business, each case must stand on its own facts. However, because of the elusive nature of the question, the courts have developed guidelines in attempting to answer this question. These guidelines include: solicitation, amount of sales, advertising, and length of time the property was held. Taxpayer notes (Br. 13) that all of these "normal criteria" are lacking here and appears to find fault with the Tax Court in not employing them in the instant case. But this case is unlike the usual case in that here the land was never sold by partnership (with the exception of 500 acres), and, obviously, the guidelines would be of no assistance. Thus in the usual case, a taxpayer has or has not employed agents, advertised, subdivided, etc., in the course of selling his land. These facts (or lack of them) are then on the record and the trier of fact, by employing the guidelines, can conclude whether the property was simply an investment that was being realized (sold) or whether the property actually had been held for sale and sold to customers in

the course of business. But as noted, here the partnership did not engage in direct sales efforts and thus, of course, all of the "normal criteria" would be lacking. However, merely because the facts here preclude the use of these guidelines does not mean that the question as to taxpayer's primary purpose cannot be determined or that the question must, as a matter of law, be resolved in taxpayer's favor; rather, taxpayer's primary purpose in holding the land is simply more difficult to determine. Accordingly, what was said at the outset, namely, that each case in this area rests on its own facts, has particular importance in the case at bar. We submit that when all the facts of this case are examined, it is clear that from beginning to end, the partnership's primary purpose in acquiring and holding this land was for sale to customers in the ordinary course of its business.

Prior to selling the land to SBIC, the then-owner, Kensington Heights Company, had, with Freeland's ^{4/} assistance, made extensive efforts to sell the raw acreage to subdividers and developers. These

^{4/} As noted previously, taxpayer contends (Br. 4, 17-18) that the imputation of the motives of Freeland and/or the other partners to her is erroneous. She urges that no matter what the other partners had in mind, she only intended to invest in the partnership and therefore, her gain should be taxed as capital gain. We submit taxpayer's contention is fallacious and her reliance on this Court's opinion in United States v. Rosebrock, 318 F. 2d 316 is misplaced. In Rosebrock, taxpayer was the beneficiary of a trust and the trustee had invested the trust's assets in a joint venture. There was no question that the joint venture had acquired and was holding the land for sale and in fact, the other joint venturers had agreed to dissolve the joint venture, hold the land for six months as tenants in common and then convey the property to a corporation in which the principal contributors of the joint venture also held interests. After the dissolution of the joint venture and while the property was being held for the six-month period, the trust was dissolved and the trust's assets, including the interest in the land, was transferred to the taxpayer. When the six-month period had passed, the tenants in common conveyed the land to the corporation. Taxpayer, upon the advice of her father, who had been

(continued on next page)

efforts proved fruitless, the reason being (in Freeland's words)

(II-R. 47):

Too far in the future. Wasn't ready for development. Market couldn't absorb--too expensive on account of the off-site work. In other words, there was too much other property as close in or closer-in that was more economical to develop and adjacent to the utilities that would be just continuing on with their present development. They were not interested in developing a new area. (Emphasis supplied.)

4/ (continued from previous page)

a principal contributor in the joint venture and who had, as trustee, invested the trust's assets in the joint venture, also joined in the conveyance. The Commissioner urged that as a matter of law the intent of the joint venture must be imputed to taxpayer so that taxpayer must be considered to have had the same intention as the principals in the joint venture, i.e., to hold the land for sale. This Court rejected such a contention as a matter of law and noted that the facts were in taxpayer's favor, for (pp. 319-320):

Here the Taxpayer's trustee acquired property in a joint venture without Taxpayer's knowledge of either the interest acquired or the nature of the venture. Prior to the time there was a sale, Taxpayer received all of the property in her trust estate. She received it without any conditions and without any obligation to sell her interest in the jointly held property to a corporation in which she had no interest and which was owned and controlled by the organizers of the joint venture, who intended to operate it for their and not her profit. In our view their intent may not be imputed to her.

The facts of the case at bar are in marked contrast to those of Rosebrook. Here taxpayer willingly made her own decision to enter the partnership; she invested her own funds; and also agreed that not only would she not take part in the partnership but that the general partners would determine the general business policy of the partnership. (Pet. Ex. 15.) Equally important is the implication that taxpayer was willing to do whatever Freeland intended to do. Thus taxpayer testified that she was interested in the partnership because Freeland was a general partner and because he sold out, she did likewise. (II-R. 185.) To be noted is that Freeland's option agreement with Tavares (Pet. Ex. 34) specifically provided that unless there was a concurrent closing of an escrow with taxpayer, then Freeland's escrow would not close (Pet. Ex. 34, Sec. 9, pp. 4-5). Therefore taxpayer's contention that the Tax Court was in error in finding that Freeland's tax treatment would control taxpayer's tax treatment is a contention devoid of merit.

Kensington, unable to sell the land, then offered it to Freeland who, together with Berger, decided to form SBIC. Kensington's terms of purchase were rejected and SBIC submitted its plan for financing the purchase. (II-R. 50.) All the negotiations were conducted by Berger who indicated that the entire area would be developed as soon as possible and that the purchase price would be paid off in about three years. (I-R. 118-119.) Because it had been unable to sell the land to developers because of the lack of off-site improvements and because, as will be discussed below, the financing arrangement had to be predicated on development, it appears that Kensington wanted to insure that development of the area would in fact take place for it, Kensington, inserted in the purchase agreement a requirement that SBIC would deposit \$200,000 in escrow for off-site improvements. As the Tax Court observed (I-R. 139): "This is a peculiar requirement for a seller to impose in a mere sale of raw acreage. Granted that such sum would not cover off-site improvements for the entire 4,500-acre tract, the imposition of such requirement mirrors the vision of development which the parties, including SBIC, had in mind."

As mentioned above, Kensington, by inserting the \$200,000 deposit requirement, was attempting to insure that development would take place. It appears that the reason for Kensington wanting development was that its financing arrangement with SBIC clearly was predicated on the assumption that the purchase price would come from the proceeds of a development. Thus the total consideration was \$4,676,666.66 (including interest), with \$100,000 down and 20 annual installments.

The first installment of \$180,000 was to be paid one year after the purchase and each of the remaining installments would be increased by \$6,000 until the 19th payment of \$288,000. The 20th installment would be in the amount of the balance, \$130,666.66. (I-R. 119.) It was contemplated that the proceeds from the sale of 500 acres to LMDC would pay the first 5 installments. This would mean that approximately \$3,500,000 still remained to be paid from that point on. Freeland's response as to how this large balance was to be paid was (II-R. 73) that there were no definite plans as to how this would be done but it would be taken care of when the need arose.^{5/} The Tax Court rejected this highly unlikely arrangement, concluding instead (I-R. 139):

The lower payments in the earlier years seem to us more likely to reflect the understanding of the parties that development would be the generating source of the funds rather than, as petitioner suggests, the desire of SBIC to hold down the amounts required to be paid until it had had an opportunity to realize on the anticipated appreciation in value.

5/ Actually Freeland suggested that, assuming the land increased, SBIC could borrow against the land. We submit that this is completely unlikely for even if the land did increase, it would be already burdened with a \$3,500,000 deed of trust and it is difficult to envision who would lend money against such collateral. Moreover, even if other loans could have been obtained, where was the capital to come from to pay this added indebtedness?

As for Freeland's other possible source of funds, i.e., contributions from the partners, this is extremely doubtful. Berger had been able to raise no more than \$30,000 of his \$100,000 share for the down payment and Freeland had to guarantee Berger's loan of \$30,000. Thus he hardly could be relied upon to contribute anything substantial towards a \$3,500,000 debt. Furthermore, although some of the partners were wealthy men, to raise the \$3,500,000 would have meant that they would have had to liquidate all their other assets, including business interests, and devote all of the capital to a tract of undeveloped land. This too, we submit, is hardly a likely assumption on which to contract a \$3,500,000 debt, especially when there was no agreement by the parties that there would be contributions.

Moreover, in an attempt to raise the \$200,000 deposit, a letter was sent to General Petroleum Corporation seeking to have that corporation lend the necessary funds. The letter stated that a master plan for the entire 4,500 acres was being completed; that it was proposed to start development of 2,000 homes; and that a minimum of 4,000 homes would be completed and occupied within three years and following this, consideration would be given to subdividers capable of proceeding with the development in a satisfactory manner. Although General Petroleum declined to provide the funds, this letter is further evidence that development of the entire tract was being planned.

All of the foregoing discussion amply demonstrates that SBIC was hardly planning, as Freeland contended (II-R. 71-72), to purchase the land, do nothing with it for 10 years, and at that time consider what to do with it. Rather, these facts indicate quite strongly that development was the primary purpose of acquiring the land. Indeed, in light of the financing arrangement with Kensington, it appears that development was a virtual necessity. We submit that had nothing further occurred other than taxpayer selling her interest in SBIC, these facts alone would have justified a finding by the Tax Court that SBIC had acquired and held the land for sale to customers in the ordinary course of business. As for the later developments, these, as will be shown, confirm that SBIC held the land for sale, not for investment.

As indicated, SBIC's purchase of the land was clearly predicated on the assumption that the tract would be developed. Because of his efforts on behalf of Kensington Heights Company, Freeland knew that

none of the developers operating in the area were interested in this tract. SBIC could not develop the tract due to Freeland's desire not to "directly * * * engage in subdividing and developing the land, either individually or through any other business form, because it would place him in competition with his clients and those of his engineering partnership and thus be financially injurious." (I-R. 132.) This fact makes it readily apparent that a solution had to be found whereby development, which had to be done to generate funds for the annual payments, could be insured and possibly regulated by SBIC and yet somehow not reveal Freeland's role in that function. We submit that the problem was solved by the creation of IMDC. Taxpayer objects (Br. 13-15) to relating IMDC's activities to SBIC, as the Tax Court did, apparently on the grounds that there was no showing that there was any common control of these two entities. However, as will be shown, there were sufficient common interests in these two entities--either through direct ownership or because of financial considerations--so as to justify relating their interests.

Despite that it partakes of a labyrinth, the record does reveal just how inter-related IMDC and SBIC were. All of IMDC's stock was held in trust by Herbert Glaser, as trustee for the corporations which made the Country Club Park ^{6/} joint venture. (I-R. 121, II-R. 257-258.) It appears that the members of the Country Club Park joint venture were: Sam Glaser; Jack, Charles, and Sam Barenfeld; Herbert Glaser; and Herbert Glaser's grandfather. Sam Glaser was Herbert's

6/ Sometimes in discussing the Country Club Park joint venture, reference is made to Chula Vista. It appears that Chula Vista is a location (development) in California where the Country Club Park joint venture was building houses. (II-R. 255-256.)

father and the three Barenfelds were uncles of Herbert. (II-R. 255-256.) As for the corporations, Sam Berger held a 20% interest in each and Herbert Glaser held a 10% interest in each. (II-R. 257.) Insofar as the Barenfelds and the Glasers controlled the joint venture, we submit that it is a fair and reasonable assumption that they held sufficient interests in the various corporations so as to control them.

Looking at the ownership interests in SBIC, it is apparent that, with the exception of Freeland and taxpayer (who together owned 40% of the partnership), all the effective interests in SBIC were held by persons directly involved in LMDC. Thus Berger held a 20% general partner interest and had control of 20% of the limited partnership interest (as trustee for the HAB and LMB trusts). (I-R. 124.) Berger was also president of LMDC. (I-R. 121, II-R. 258.) The remaining 20% was held by Lake Murray Trust No. 1, which originally consisted of Jack Barenfeld and Sam Glaser, but these two gave a 10% interest to the other members of the Country Club Project. (I-R. 124.) Moreover, SBIC's Limited Partnership Agreement provided that in the event of policy differences between the general partners, a board of arbitration would be convened. Of the two specified arbitrators (who would choose the third), one was Herbert Glaser, who, of course, as trustee, had complete control over LMDC. (Pet. Ex. 15, p. 8.)

Freeland's lack of ownership in LMDC is readily explained by his desire not to compete directly with his other clients in development. Insofar as taxpayer was Freeland's private secretary in his engineering work and his nominee in SBIC, presumably this was why she also was not a stockholder in LMDC. However, it does not

follow that Freeland had no interest in LMDC's affairs for he apparently was to receive a fee from LMDC of \$25 per lot (I-R. 130), and his engineering partnership was employed by LMDC (I-R. 126). It is possible that Freeland hoped that as consultant to LMDC and through his engineering partnership, he could exercise some control of LMDC's affairs, even though not a stockholder.

Clearly then, taxpayer's contention that there was no common control is to insist upon the formality that she and Freeland, for example, had to be stockholders of record in LMDC; "But the tax law deals in economic realities, not legal abstractions * * *." Commissioner v. Southwest Expl. Co., 350 U.S. 308, 315; Weinert's Estate v. Commissioner, 294 F. 2d 750 (C.A. 5th).

Once the interlocking relationship of the two entities is recognized, it makes it relatively simple to understand other facts of this case. Thus it is easy to see why, in the original plan between LMDC and SBIC, the latter guaranteed that the cost of off-site improvements would not exceed \$200,000^{7/} and that its cost of the homes to be constructed and sold would not exceed fixed amounts. (I-R. 143.) As the court stated (I-R. 143): "Such undertakings are unusual on the part of a pure seller of acreage and are indicative of a plan for the partners of SBIC to be involved in active development."

Also to be remembered is that Freeland testified (II-R. 73) that the sale of 500 acres to LMDC would generate sufficient income to pay for the first 5 or 6 annual installments. To purchase the land

^{7/} The same agreement provided that LMDC deposit \$200,000 for off-site improvements. (I-R. 142.) Thus SBIC was imposing the same condition on LMDC as had been imposed on it, SBIC, by Kensington Heights Company.

on this basis, it is obvious that SBIC had to be sure that LMDC would purchase 500 acres. (LMDC had only an option to purchase which, of course, it was not required to exercise.) As the Tax Court concluded (I-R. 142-143): "These interlocking participations provided the real guarantee that the option would be exercised."

In similar fashion, the interlocking relationship explains why LMDC was able to advertise, when LMDC's model homes were shown to the public, that a "City of Tomorrow" was to be developed on the entire 4,500 acres. (I-R. 127.)^{3/} It also explains how SBIC, through Berger, was able to represent to Kensington that the entire purchase price would be paid in three years. (I-R. 119.) Further confirmation that Kensington was to be paid in a short period of time is found in the fact that while the SBIC-Kensington contract provided for a 20 year pay-out, SBIC's partnership agreement provided that SBIC was to have a term of 10 years. And, of course, as the Tax Court observed (I-R. 143-144):

A further indication of SBIC's involvement in the development activities of LMDC is contained in the price at which acreage was sold to it by SBIC. The purchase from Kensington and the grant of the option to LMDC took place at the same time. Yet,

3/ Although Freeland contended (I-R. 127) he disapproved of such advertising by LMDC, it is interesting to note that SBIC's efforts to have the School District acquire acreage for schools, parks, and recreational purposes (I-R. 128-129), if successful, would have been a significant aid towards the creation of a "City of Tomorrow" on the tract. At the very least, SBIC's efforts, again if successful, would have enhanced the value of the land and such efforts cast considerable doubt on taxpayer's contention that SBIC was simply a passive holder of raw acreage (which it hoped would increase in value over a period of years).

LMDC was required to pay \$2,000 per acre although SBIC acquired the land from Kensington at \$1,037 per acre (\$800 plus interest). The discrepancy in price is substantial. We recognize that a small portion of the discrepancy may reflect the fact that some of the acreage would be devoted to public purposes such as streets, parks, etc. Perhaps the acreage sold by SBIC to LMDC was more valuable than other portions of the total tract. Petitioners did not see fit to enlighten us on these scores. In our view, the circumstances strongly suggest that the price was arbitrarily arrived at as a method of siphoning off to the common participants in SBIC and LMDC a portion of the latter's profit hopefully as long-term capital gains. In this connection, we note that, while Freeland did not have an ownership participation in LMDC, he could reap his financial reward from that entity via direct personal engineering fees and fees paid to his engineering partnership.

In light of all of this evidence, it is obvious that LMDC and SBIC were working in unison to implement SBIC's primary purpose--to sell the land which would in turn be developed. Or as the Tax Court concluded (I-R. 146):

We think that, from the beginning, the partners in SBIC intended to sell off the property as quickly as the area could be made ready for development and that to this end they planned actively and continuously to participate in sequential development efforts. LMDC was the primer for the entire project. It was the first vehicle to be utilized and the partners of SBIC were deeply involved in the activities of that entity.

Taxpayer next contends (Br. 15) that even if there was an inter-relationship between the two entities at one time, this relationship ended when LMDC became insolvent. Because taxpayer does not pursue this point, we are somewhat at a loss to understand what her argument is. If, as implied, taxpayer's contention is that once the inter-relationship ended, SBIC's original plan to sell the land

changed to one of investment, we submit that such contention is fallacious. This is because taxpayer fails to appreciate that the decline of LMDC does not require that SBIC's purpose in holding the land had to change. Thus that SBIC intended to have the land developed in order to make sales of land is quite apparent in the record. Equally true is that SBIC was going to utilize LMDC as a vehicle to have the development get under way. LMDC began to develop but then, because of financial difficulties, it went out of business. But this does not mean that SBIC's purpose had to change--as taxpayer appears to be urging--but only that SBIC might then have had to look for another developer. Stated differently, if a wholesaler is holding inventory for sale to a retailer and the retailer goes out of business, it does not follow that at that moment, the wholesaler's purpose in holding the inventory has changed, so that the wholesaler is now holding the items for investment purposes. In short, we disagree with taxpayer's contention that this fact--LMDC's demise--standing alone necessitates a finding that SBIC's purpose changed accordingly. ^{9/}

^{9/} Taxpayer also suggests (Br. 15) that because of the impasse between Tavares, who wished to develop, and Freeland, who refused to join with Tavares in development work, this means that SBIC could not have any primary purpose and therefore, it was error to find that SBIC's primary purpose was sale. The flaw in taxpayer's analysis is that until Freeland and taxpayer sold their interests, at which time the sale by Berger to Tavares was consented to, Tavares had no standing, i.e., was not a general partner, to determine what SBIC's policy was or would be.

Moreover, the facts following LMDC's demise clearly show that SBIC did not change its purpose in holding the land. If anything, they reflect that from beginning to end, SBIC planned to sell its land to developers and when the first developer (LMDC) failed, then SBIC (through its partners) sold the land to another developer (Tavares). Thus LMDC's activities came to an end in May. On August 10, Berger sold his and the trust's interests. In less than a month, i.e., September 7, 1956, Freeland entered into an option agreement with Tavares, giving Tavares the right to purchase Freeland's and taxpayer's interests. (Pet. Ex. 34.) The negotiations for sale of 80% of the partnership occurring within four months from the time the purported change in purpose occurred casts considerable doubt that there ever was in fact an agreement to hold the land for investment. Also, it is difficult to believe that Berger would decide in May to hold the land for investment--which would mean making payments on the land without not having any income from the land--when presumably he was already in financial difficulties which necessitated his sale in August. To be remembered is that Freeland claimed that SBIC would be able to finance the land without selling it (that is, while being held as an investment) either by borrowing on the appreciated value of the land or by having the various partners make contribution. Not only is the record barren of any evidence that either procedure was even discussed by the partners, but Berger's financial difficulties clearly demonstrate that SBIC could hardly have purchased the land on the assumption that the partners would supply the necessary funds as required.

Furthermore, if SBIC had changed its purpose, what then accounts for Freeland and taxpayer selling their interests? Although Freeland testified that his sale was against his desires (II-R. 94), this hardly goes to answer the question why Freeland would sell out after purportedly having decided to hold the land for investment. Insofar as Freeland was a general partner, he could have had Berger's sale to Tavares set aside (Freeland agreed to Berger's sale as part of his, Freeland's, sale agreement with Tavares). Also, even if Berger's sale had been accepted by Freeland, Freeland still was one of the two general partners and hence, could have insisted that the alleged reason for SBIC's holding the land be continued, i.e., investment.

The foregoing discloses that any contention by taxpayer that LMDC's demise brought about a change in purpose is a contention without merit. As the Tax Court stated (I-R. 136):

Similarly, the record shows clearly that the plans of SBIC at the time of acquisition of the property continued to govern its subsequent activities so that we are not faced with a situation involving a change of purpose.

This then brings us to taxpayer's last contention (Br. 16), namely, if the gain results solely from the fact that the land has appreciated in value, then the gain has to be taxed as capital gain. Taxpayer's point is not well taken for it is somewhat of a boot strap argument. Thus if the trier of fact determines that the land was simply held as an investment, then the gain is capital gain. If however, the trier of fact determines that the land was being held for sale to customers in the course of trade, i.e., not as an investment, then taxpayer would have the Court determine if the land

increased solely from outside forces (growth of a city, etc.), and if so, then the Court would have to say the land was an investment. If so, then the Court's entire inquiry as to the purpose for which the land was being held would be vitiated by this one fact. True, business activities will usually result in a higher price for the land but if a dealer bought acreage, admittedly held it as part of his inventory, making many efforts to sell, and then the land increases because a business has decided to locate nearby, then taxpayer would urge the land had not been held for sale to customers. We submit that such a conclusion would be contrary to the capital gains provisions. Even if taxpayer's analysis were correct, the fact is that the land increased because of development work, not because of appreciation. Thus Tavares stated (Dep. 19-20) that development of the 150 acres had increased the value of that land and the contiguous property as well. In other words, the work done by LMDC, which presumably included some--if not all-- the off-site improvement work required by SBIC gave rise to the land's increase in value. Insofar as SBIC's agreement with LMDC virtually assured that the work would be done, the development work, although done in LMDC's name, must be attributed to SBIC. Accordingly, it is not unrealistic to say that SBIC's efforts gave rise to the increase in value.

In the final analysis, the Tax Court found that taxpayer did not carry her burden in proving that this land was not being primarily held for sale to customers in the ordinary course of business. There is ample evidence in the record to support this finding and taxpayer has not shown it to be clearly erroneous.

ARGUMENT

II

THE TAX COURT WAS CORRECT IN DECIDING THAT THE COMMISSIONER HAD NOT ABUSED HIS ADMINISTRATIVE DISCRETION IN REOPENING TAXPAYER'S INCOME TAX RETURN WHICH HAD BEEN PREVIOUSLY AUDITED

Unless there is a closing agreement pursuant to Section 7121, a court decision, or the bar of the statute of limitations, there is no statutory restriction on the Commissioner reopening a previously audited return. However in order to insure that taxpayers will not be unduly inconvenienced by repeated audits, the Commissioner has set up an administrative procedure to be followed when a previously audited return is to be reopened. Rev. Proc. 59-25, 1959-2 Cum. Bull. 938 Appendix, infra (superseded by Rev. Proc. 63-9, 1963-1 Cum. Bull. 488 and Rev. Proc. 64-40, 1964-2 Cum. Bull. 971).

Rev. Proc. 59-25 provides that where there is additional information received by the District Director's office, either from within or from outside the Internal Revenue Service, a case may be considered for reopening. In the instant case, the Internal Revenue Agent who audited taxpayer's return testified (II-R. 242-243) that he had not examined any of the files of any of the partners of SBIC, other than taxpayer and Freeland. As has been discussed above, this case rests in large part on the knowledge of the inter-relationship of LMDC and SBIC and without knowledge of such inter-relationship, it could be seen why this Agent believed the gain should be taxed as capital gain. On the other hand, another Agent audited the returns of other partners of SBIC (II-R. 250) and, of course, any one of these

other partners had a direct ownership in LMDC. Obviously then, this other audit would have produced the additional information which presumably led to reopening taxpayer's previously audited return. In this regard then, the Commissioner acted in accordance with his administrative practice.

Rev. Proc. 59-25 also provides:

It is the administrative practice of the Internal Revenue Service not to reopen cases previously closed by the District Director unless there has been substantial error, both in amount and in relation to the total tax liability, or there is evidence of fraud, malfeasance, collusion, concealment or the misrepresentation of a material fact.

It is this provision that taxpayer contends (Br. 18-20) was not adhered to herein. There has been no contention by the Commissioner that there was any evidence of fraud, collusion, concealment, or the misrepresentation of a material fact. Accordingly the question is whether there was a substantial error, both in amount and in relation to the total tax liability, so as to justify the Commissioner's reopening this case. In this regard, the Tax Court found (I-R. 150):

The deficiencies assessed against * * * Lowthian for 1956 * * * [is] \$10,231.29, whereas the tax as disclosed by * * * [the] return for 1956, is * * * \$4,085.34. Thus, both elements of the substantial error test of Rev. Proc. 59-25 have been met.

Taxpayer contends (Br. 19) that substantial error does not have reference to dollar amounts but only to the kind of error. That is, where there is a factual case and therefore, judgment is involved, the original audit is controlling. We submit that such reasoning is fallacious because the Revenue Procedure specifically relates error

to dollar amount, not to the type of question involved. Addressing itself to this contention, the Tax Court stated (I-R. 150):

* * * [Taxpayer's] error lies in a failure to note that the Revenue Procedure is concerned only with certain types of "substantial error," that is, "both in amount and in relation to the total tax liability." * * * It would be paradoxical if "substantial error" were to depend upon the analysis of the closeness of the very question which the court is called upon to decide. (Emphasis supplied). 10/

Accordingly, we submit that taxpayer has in no way shown any abuse on the Commissioner's part in reopening her 1956 income tax return. 11/

11/ Taxpayer submits (Br. 20) that where a deduction is claimed in error which is accepted by the agent conducting the audit, and if later the Commissioner reopened the tax return, this would not be an abuse of discretion. We submit that taxpayer's example differs little from the instant case and is a distinction without a difference. Thus we see little to distinguish the instant case from the case where an agent accepts taxpayer's deduction but later, additional evidence indicates that the expenditure should have been capitalized. In both instances, there is a difference in tax treatment yet taxpayer would say that to reopen the former tax return would be an abuse of discretion (i.e., this case) but this would not be so if the latter tax return were to be reopened.

11/ Taxpayer's complaint (Br. 19) that the reopening of this case by the Commissioner has resulted in tremendous interest on the asserted deficiency was also presented to the Tax Court, which concluded (I-R. 150-151):

Beyond the foregoing, we note that petitioners kept their returns open by voluntarily executing consents extending the period of limitations. They do not contend that any of these consents were invalid or that the period of limitations had otherwise run. The letter of respondent indicating the favorable disposition of the issue involved herein was dated September 19, 1958, and the case was not reopened until April 26, 1962, more than three-and-a-half years later. The petitioners had ample opportunity to protect themselves against the alleged abuse of discretion and the burden of interest about which they now complain.

CONCLUSION

For the foregoing reasons the decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

MITCHELL ROGOVIN,
Assistant Attorney General.

LEE A. JACKSON,
DAVID O. WALTER,
MARCO S. SONNENSCHN,
Attorneys,
Department of Justice,
Washington, D. C. 20530.

DECEMBER, 1967.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: _____ day of _____, 1967.

MARCO S. SONNENSCHN
Attorney

APPENDIX

Internal Revenue Code of 1954:

SEC. 741. RECOGNITION AND CHARACTER OF GAIN OR LOSS ON
SALE OR EXCHANGE.

In the case of a sale or exchange of an interest in a partnership, gain or loss shall be recognized to the transferor partner. Such gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset, except as otherwise provided in section 751 (relating to unrealized receivables and inventory items which have appreciated substantially in value).

(26 U.S.C. 1964 ed., Sec. 741.)

SEC. 751. UNREALIZED RECEIVABLES AND INVENTORY ITEMS.

(a) Sale or Exchange of Interest in Partnership.--The amount of any money, or the fair market value of any property, received by a transferor partner in exchange for all or a part of his interest in the partnership attributable to--

(1) unrealized receivables of the partnership, or

(2) inventory items of the partnership which have appreciated substantially in value,

shall be considered as an amount realized from the sale or exchange of property other than a capital asset.

*

*

*

(d) Inventory Items Which Have Appreciated Substantially in Value.--

(1) Substantial appreciation.--Inventory items of the partnership shall be considered to have appreciated substantially in value if their fair market value exceeds--

(A) 120 percent of the adjusted basis to the partnership of such property, and

(B) 10 percent of the fair market value of all partnership property, other than money.

(2) Inventory items.--For purposes of this subchapter the term "inventory items" means--

(A) property of the partnership of the kind described in section 1221 (1),

*

*

*

(26 U.S.C. 1964 ed., Sec. 751.)

Rev. Proc. 59-25, 1959-2 Cum. Bull. 938:

Section 1. Purpose.

.01 The purpose of this Revenue Procedure is to set forth the conditions applicable to the reopening of cases examined and closed in the office of a District Director of Internal Revenue.

Sec. 2. Scope.

.01 For the purposes of this procedure, a closed case is any income, estate, gift, excise or employment tax return closed by examination in the office of the District Director, in which the taxpayer has been notified in writing by the District Director of the adjustment in tax liability or the acceptance of the return as filed.

*

*

*

Sec. 3. Background.

.01 Cases closed in the office of the District Director may be considered for reopening as a result of additional information received by the District Director's office. This information may come from within or outside the Internal Revenue Service.

*

*

*

Sec. 4. Conditions for Reopening.

.01 It is the administrative practice of the Internal Revenue Service not to reopen cases previously closed by the District Director unless there has been substantial error, both in amount and in relation to the total tax liability, or there is evidence of fraud, malfeasance, collusion, concealment or the misrepresentation of a material fact. Reopening as the result of additional information received by the District

Director's office must have the approval of the District Director, and reopenings recommended as a result of post review action must have the approval of the Assistant Regional Commissioner (Audit).

*

*

*

No. 21795-A

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MARGARET C. LOWTHIAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S REPLY BRIEF.

ADAM Y. BENNION,

523 West Sixth Street,
Los Angeles, Calif. 90014,

CHARLES E. BURCH, JR.,

JOHN B. GREGORY,

2101 First National Bank Bldg.,
San Diego, Calif. 92101,

Attorneys for Petitioner.

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DEC 27 1967

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No. 21795-A
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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S REPLY BRIEF.

I.

The Partnership SBIC Was Not Engaged in the Business of Selling Land to Customers in the Ordinary Course, and the Land in Question Was Not Held Primarily for Sale in Such a Business.

The Commissioner's argument is that in the purchase of the land in question it was obviously intended that the land would be developed (in order to pay the purchase price); the seller imposed restrictions which would assure that some of the land would be developed; and since some of the partners of the purchasing partnership (SBIC) had interlocking relationships with a development company which had an option to acquire 500 acres of the 4,500 acres in question, the purchaser SBIC must be held to have held all the land in question primarily for sale to customers in the ordinary course of its trade or business.

We submit there is a glaring fallacy here. Admittedly, development of a portion of the land was contemplated. As the Commissioner states, "It was contemplated that the proceeds from the sale of 500 acres to LMDC would pay the first 5 installments." (Br. 29). Also, "* * * the sale of 500 acres to LMDC would generate sufficient income to pay for the first 5 or 6 annual installments." (Br. 33).

But we are not dealing here with this first 500 acres—acres which were subject to option to LMDC at the time the SBIC partnership acquired the land. The development and sale by LMDC of those 500 acres obviously would result in ordinary income to it. That is beside the point.

And it is equally obvious why the seller would be interested in having some development take place on its property, in the event a repossession were necessary.

We are concerned here, however, with the balance of the land: was it held by the partnership SBIC for investment or was it held primarily for sale to customers in the ordinary course of a trade or business of SBIC of selling property to customers?

The Commissioner admits that none of the usual criteria are present here, such as solicitation, amount of sales, advertising, the length of time held, etc. (Br. 25-26). But the Commissioner seeks to brush this absence aside as merely making it more difficult to determine the taxpayer's primary motive (Br. 26).

This, we submit, is a shallow analysis. The general guidelines or criteria are not resorted to in a vacuum or for mere intellectual pursuit. Rather, the statutory language requires a determination as to whether a

taxpayer is engaged in a trade or business of selling property to customers in the ordinary course, and, if so, whether the property in question is held *primarily* for sale to such customers in the ordinary course of such trade or business.

Now, the guidelines are resorted to in an effort to determine whether the taxpayer is in fact engaged in a trade or business of selling property to customers in the ordinary course. And in this respect the activities of the taxpayer are important. Were sales solicited? Did the taxpayer advertise? How numerous were the transactions?

Here we admittedly have none of these things. No advertising. No solicitation of sales. No amount of sales. In fact, no sale at all by this partnership out of property not subject to the option outstanding when it acquired the property.

So, we revert to the question: was this entity, SBIC, though it did none of these things, engaged in the business of holding land for sale to customers in the ordinary course and was the land in question so held?

The Commissioner argues that, no, the SBIC partnership did not engage in such business directly, but some of its partners were involved as "interlocking participants" in the development company that had the option on the 500 acres, and if all had gone well additional acreage would have been sold to the development company or to other developers.

But the facts are that petitioner Margaret C. Lowthian was not one of such "interlocking participants." Things did not go well. The development company went bankrupt. And there was no sale by SBIC of

any acreage to that company or to any other developer.

So, we revert to the question: was SBIC engaged in the business of selling land to customers in the ordinary course of its business? It never made such a sale. It was not engaged in such a business.

II.

The Commissioner's Attempted Distinction of United States v. Rosebrook (C.A. 9, 1963) 318 F. 2d 316, Is Without Merit.

The Commissioner devotes footnote 4 (Br. 26-27) to an attempt to distinguish *United States v. Rosebrook* (C.A. 9, 1963), 318 F. 2d 316. The Commissioner quotes from the *Rosebrook* opinion—

“* * * She received it (her interest in the property) without any conditions and without any obligation to sell her interest in the jointly held property to a corporation in which she had no interest and which was owned and controlled by the organizers of the joint venture, who intended to operate it for their and not her profit. In our view their intent may not be imputed to her.”

The Commissioner then asserts that Margaret C. Lowthian, in marked contrast, “willingly made her own decision to enter the partnership; she invested her own funds; and also agreed that not only would she not take part in the partnership but that the general partners would determine the general business policy of the partnership.”

But the point is this: Margaret C. Lowthian invested her money in an entity which “did not engage in direct sales efforts” (Comm. Br. 26), and which the Commissioner asserts held property for sale to customers only

because of and in the light of “interlocking participations” between some of SBIC’s partners and LMDC. But in these “interlocking participations,” if they existed, Margaret C. Lowthian had no interest; and these “interlocking participations” were not intended to be operated for her profit. She had no interest in them. As this Honorable Court stated in the *Rosebrook* opinion:

“* * * The able District Judge in a well-reasoned opinion pointed out that not all participants in a joint venture need have the same intent and purpose. ‘For some it may be just a step in carrying on their business; for others it may be merely a single opportune investment with a view of ultimate profit but unrelated to any business of the participant, as in the case of (Taxpayer) * * * here’.”

If, as seems to be the case here, the sole basis for an adverse decision, as to some of the partners in the present joint venture, is that this was merely “a step in carrying on their business,” as evidenced by their direct or indirect participation in a development company, the fact is that as to Margaret C. Lowthian this was “a single opportune investment with a view of ultimate profit” but unrelated to any business in which she was engaged, either directly or indirectly.

In other words, if the interlocking relationship is the basis for branding certain participants with ordinary income, that basis is and always was lacking as to Margaret C. Lowthian. Their intent, the intent of the interlocking participants, may not be imputed to her.



N O. 2 1 8 0 1

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

ADAI LESER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA
CENTRAL DIVISION

FILED

AUG 23 1967

WM. B. LUCK, CLERK

WM. MATTHEW BYRNE, JR.,
United States Attorney,
DAVID R. NISSEN,
Assistant U. S. Attorney,
Chief, Special Prosecutions
Division,

827 U. S. Court House
312 North Spring Street
Los Angeles, California 90012

Attorney for Appellee,
United States of America.

AUG 25 1967

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Chief, Special Prosecutions
Division,

827 U. S. Court House
312 North Spring Street
Los Angeles, California 90012

Attorney for Appellee,
United States of America.



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N O. 2 1 8 0 1
IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

ADAI LESER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF

I

JURISDICTION AND
STATEMENT OF THE CASE

On June 20, 1962, the Federal Grand Jury for the Southern District of California, returned indictment No. 30956, charging appellant and a co-defendant with 35 counts of mail fraud in violation of Title 18, United States Code, Section 1341. Thereafter, on October 31, 1963, a jury returned verdicts of guilty on 31 counts and on November 18, 1963, appellant was sentenced to a total period of imprisonment of 17-1/2 years and was fined sums totalling \$50,000. Notice of Appeal was filed the same day.

Appellant's conviction was affirmed by this Court in Case



No. 19093 on March 19, 1966. Appellant's Petition for Rehearing was denied on April 20, 1966 [See Leser v. United States, 358 F.2d 313 (9th Cir. 1966)]. The United States Supreme Court dismissed appellant's petition for certiorari on September 28, 1966. [See Leser v. United States, 358 U.S. 802 (1966).]

On December 9, 1966, appellant filed a Motion to Vacate Sentence under Title 28, United States Code, Section 2255, which was designated as Case No. 66-1980-PH. On January 11, 1967, appellant's Motion was denied by United States District Judge Pierson M. Hall. On April 18, 1967, appellant filed his Notice of Appeal which contained the statement that he had received no notice of the denial of his motion until February 3, 1967.

Appellee contends that this Court lacks jurisdiction in this matter by virtue of appellant's failure to file a timely Notice of Appeal as required by Rule 73(a), Federal Rules of Criminal Procedure.

II

STATUTES INVOLVED

Title 28, United States Code, Section 2255, provides in pertinent part:

"A prisoner in custody under sentence of a court established by Act of Congress claiming the right to be released upon the ground that the sentence was imposed in violation of the constitution



or laws of the United States, or that the Court was without jurisdiction to impose such sentence, or that the sentence was in excess of the maximum authorized by law, or is otherwise subject to collateral attack, may move the Court which imposed sentence to vacate, set aside or correct the sentence."

III

STATEMENT OF FACTS

Appellee adopts as its statement of facts those set forth by this Court in its opinion affirming appellant's conviction in Leser v. United States, 358 F.2d 313 (9th Cir. 1966).

IV

ARGUMENT

A. THIS COURT IS WITHOUT JURISDICTION.

The record shows that appellant filed his Notice of Appeal 74 days after the District Court denied his Motion to Vacate Sentence. This is beyond the 60 days prescribed by Rule 73(a) of the Federal Rules of Civil Procedure for the filing of a Notice of Appeal.



B. THE DISTRICT COURT PROPERLY
DENIED APPELLANT'S MOTION.

The sole ground of appellant's motion was that an alternate juror had unlawfully been substituted for a regular member of the jury. In denying appellant's motion, the District Court found that: "The United States Court of Appeals specifically passed upon all of the claims set forth in their instant petition and found them to be without merit." In fact, this Court in Leser v. United States, 358 F.2d 313 (9th Cir. 1966); did consider and discuss at length this particular claim of appellant's and found it to be without merit. Obviously, the question of substitution of a juror has already been decided. Section 2255 does not provide a method for relitigating matters which have already been decided on direct appeal. United States v. Marchese, 341 F.2d 782 (9th Cir. 1965); Matysek v. United States, 339 F.2d 389 (9th Cir. 1964), cert. denied 381 U.S. 917 (1964); Perno v. United States, 245 F.2d 60 (9th Cir. 1957); Evans v. United States, 346 F.2d 512 (8th Cir. 1965); Sykes v. United States, 341 F.2d 104 (8th Cir. 1965); Butler v. United States, 340 F.2d 104 (8th Cir. 1965); Ingram v. United States, 299 F.2d 351 (5th Cir. 1962); Smith v. United States, 265 F.2d 14 (5th Cir. 1959); Gallarelli v. United States, 260 F.2d 259 (1st Cir. 1958), cert. denied 359 U.S. 938 (1958).



CONCLUSION

For the reasons stated above, the court should dismiss appellant's appeal for want of jurisdiction, or in the alternative, should affirm the District Court's denial of appellant's Motion to Vacate Sentence.

Respectfully submitted,

WM. MATTHEW BYRNE, JR.,
United States Attorney,

DAVID R. NISSEN,
Assistant U. S. Attorney,
Chief, Special Prosecutions
Division,

Attorneys for Appellee,
United States of America.

No. 21802 ✓

In the
United States Court of Appeals
For the Ninth Circuit

MARICOPA TALLOW WORKS, INC., W. J.
Gieszl, Thomas E. Lewis, Ned Lewis,
T. L. Bergen, Robert L. Poer, and Ana-
heim Citrus Products Co., Inc.,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

Brief of Appellants

LEWIS ROCA SCOVILLE
BEAUCHAMP & LINTON

By JOHN P. FRANK
JOHN J. FLYNN
PAUL G. ULRICH

114 West Adams Street
Phoenix, Arizona 85003

Attorneys for Appellants

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SORG PRINTING COMPANY OF CALIFORNIA, 346 FIRST STREET, SAN FRANCISCO 94105

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No. 21802

In the
United States Court of Appeals
For the Ninth Circuit

MARICOPA TALLOW WORKS, INC., W. J.
Gieszl, Thomas E. Lewis, Ned Lewis,
T. L. Bergen, Robert L. Poer, and Ana-
heim Citrus Products Co., Inc.,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

Brief of Appellants

JURISDICTION

This matter arises in connection with a Grand Jury proceeding at Phoenix, Arizona. Appellant Maricopa Tallow Works, Inc. was subpoenaed duces tecum and filed a motion to quash; the other appellants intervened in these proceedings and asserted their individual privilege against self-incrimination and their claim to immunity. An order denying the motion to quash in part and granting it in part was entered on December 6, 1966 (R. 35-36), but was later reversed by the district court in relevant particulars on Feb-

ruary 8, 1967. (R. 112-13). The district court thereupon entered a stay of its order pending appeal to this Court (R. 138). The Notice of Appeal was filed on February 28, 1967 (R. 114) and a bond for costs on appeal was posted on February 28, 1967 (R. 115). This Court has jurisdiction under 28 U.S.C. sec. 1291.

STATEMENT OF THE CASE

This matter has arisen in the course of an antitrust Grand Jury investigation of the hide, dead stock, and tallow industry. On November 21, 1966 (R. 29) the Government caused a subpoena duces tecum to be issued to Maricopa Tallow Works, Inc., an Arizona corporation, directing that certain designated corporate records be produced for Grand Jury inspection purposes. The subpoena demanded production of records relating to ownership of the corporation, the volume and prices of materials bought and sold by the corporation, division or allocation of suppliers of material, and stabilization of prices to be paid for materials, as well as records relating to Bootstrap Trading Company, a competitor in the industry, and Emil Kohn, its owner. (R. 29-34).

Maricopa Tallow is an extremely closely held corporation. From 1960-1965, four persons each held approximately 25 percent of its stock, and these same men were also the corporate directors and officers. (R. 11). In June, 1965, two of these four persons terminated as shareholders, and were replaced by a corporation and by another individual owner, who is presently secretary-treasurer of the corporation. The corporate owner holds less than one quarter of the stock (R. 11); three individuals own the great majority of shares. This small group of directors and officers has been for practical purposes the working staff of the concern

throughout the period to which the subpoena was directed, 1960 to date.

1. The Subpoena and the Motions.

The subpoena of November 21, 1966, called very comprehensively for the records of the corporation and, for that matter, numerous personal papers which were not records of the corporation. (R. 29-34). On December 2, 1966, Maricopa Tallow moved to quash the subpoena on grounds of its claimed privilege against self-incrimination (R. 4).

At the same time, the six present and former shareholders, officers, and directors of Maricopa Tallow filed two motions of their own. First, they asked leave to be permitted to intervene on behalf of the corporation with respect to the motion to quash (R. 1). Second, they also moved to quash the subpoena directed to the corporation on the ground that the subpoena violated the grant of immunity of 15 U.S.C. Sees. 32-33 as to them individually, and on the further ground that it violated their individual privilege against self-incrimination (R. 4).

2. Proceedings Below: The First Orders.

On December 6, 1966, the district court, after extensive argument and briefing, granted the motion of the shareholders, officers, and directors for leave to intervene. (R. 35). The motion to quash was granted insofar as the subpoena required the production of personal papers; the scope of the materials required to be produced was limited to the corporate records of the corporation (R. 35).

There followed paragraph 3 of the Order, which is the substance of the present controversy. In that paragraph the district court held:

"3. With respect to the materials furnished to the Grand Jury by reason of the subpoena heretofore issued, it is ordered that these materials may only be used for purposes of investigating possible criminal activity on the part of Maricopa Tallow Works, Inc. and may not be used for the purpose of investigating any possible criminal activity on the part of any of the above named individuals." (R. 35-36).

3. Proceedings Below: Modification of the Order.

On the Government's Motion for Modification (R. 37) the trial court struck paragraph 3 of the Order.¹ The essential issue in respect to paragraph 3 is the weight and treatment to be given to the decision of this Court in *Wild v. Brewer*, 329 F.2d 924 (9th Cir. 1964), in relation to more recent decisions of the United States Supreme Court. It appeared to the district court on rehearing that *Wild v. Brewer* controlled the instant case (R. 112). If the view of the majority in *Wild v. Brewer* were to prevail, then there was strong argument to delete paragraph 3. If the view of Judge Madden in dissent were to prevail, then the court had been right in the first time. There was no issue below as to whether the district court should follow the law; of course it should. But there was a very substantial question as to whether with the passage of time, and with additional decisions on the subject of self-incrimination, the dissenting view in *Wild v. Brewer* had gained in strength and persuasiveness.

In addition, appellants argued in the district court both at the time of hearing on the motion to quash and on the

1. A member of the district court bar, Robert C. Hackett, Esq., who stated at the time of argument of this motion that he represented Bootstrap Trading Co., a competitor of Maricopa Tallow, (Hearing on modification Tr. 4), was allowed to appear amicus on this issue. (R. 144).

Government's motion for modification that *Wild v. Brewer* was not controlling because that case did not consider the propriety of an order directing that the corporate records be produced but that their use be limited to investigations directed towards persons other than the intervenors. (Hearing on motion to quash Tr. 8-9, 16-21; hearing on motion to modify Tr. 17-28). The Government agreed. (Hearing on motion to quash Tr. 21-22).

4. This Appeal and the Stay.

An appeal was promptly taken. In view of the substantial questions presented as to the scope of the privilege against self-incrimination and the immunities under the antitrust laws, the district court granted a stay pending the appeal. For details and record references, see the Jurisdictional Statement above.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

United States Constitution, amendment V:

"No person . . . shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law"

15 U.S.C. sec. 32:

"No persons shall be prosecuted or be subjected to any penalty or forfeiture for or on account of any transaction, matter, or thing concerning which he may testify or produce evidence, documentary or otherwise, in any proceeding, suit, or prosecution under sections 1-7 of this title and all Acts amendatory thereof or supplemental thereto, and sections 8-11 of this title: Provided, That no person so testifying shall be exempt from prosecution or punishment for perjury committed in so testifying."

15 U.S.C. sec. 33:

“Under the immunity provisions in section 32 of this title, immunity shall extend only to a natural person who, in obedience to a subpoena, gives testimony under oath or produces evidence, documentary or otherwise, under oath.”

SPECIFICATION OF ERRORS RELIED UPON

1. The district court erred in denying the motion of appellant Maricopa Tallow Works, Inc. to quash a subpoena requiring production of certain corporate records of that corporation, for the reason that the test of whether a corporation may claim the privilege against self-incrimination under the fifth amendment should be that applied in *United States v. White*, 322 U.S. 694, 64 S.Ct. 1248, 88 L.Ed. 1542 (1944), and under that test, appellant Maricopa Tallow Works, Inc., is entitled to assert the privilege.

2. The district court erred in denying the motion of the individual appellants to quash the subpoena directed to Maricopa Tallow Works, Inc. for the reason that the denial of that motion invades the immunity granted to them under 15 U.S.C. secs. 32-33 and further is an invasion of their privilege against self-incrimination.

3. Assuming that the district court properly entered paragraph 3 of its order of December 6, 1966, limiting the use to which the records of appellant Maricopa Tallow Works, Inc., could be put, the district court erred in granting the motion of the United States for modification of its order by deleting that paragraph. The failure to limit the use to which the corporate records obtained under this subpoena could be put violates immunity given to the individual appellants under 15 U.S.C. secs. 32-33 and invades their privilege against self-incrimination.

4. The district court erred in holding that appellants could not claim their privilege against self-incrimination as to records sought to be produced by the subpoena issued to appellant Maricopa Tallow Works, Inc. for the reason that the subpoena invades both the corporations' and the individuals' privilege against self-incrimination.

QUESTIONS PRESENTED

1. Must a closely held corporation produce records under a Grand Jury subpoena where the records necessarily involve its small number of shareholders and officers without extending to those individuals full privileges under the self-incrimination clause of the fifth amendment and under the immunity provisions of the antitrust laws, where those shareholders and officers directly and actively participate in the management of the corporation?

2. Where records of a closely held corporation are subpoenaed in an antitrust investigation, have the small number of shareholders and officers necessarily involved in all corporate affairs a right to protection of their rights against self-incrimination as to their statutory immunity in connection with the subpoena?

3. In connection with Question 2, may a court properly limit the use of the materials produced to insure protection of the privilege against self-incrimination of individual shareholders and officers and to safeguard the immunity provided by the antitrust statutes?

SUMMARY OF ARGUMENT

The issue presented by this case is whether a small, closely-held corporation and its officers, shareholders and directors may claim the fifth amendment privilege against self-incrimination so as to oppose successfully the produc-

tion of records of the corporation demanded by the Government during an antitrust investigation. 15 U.S.C. secs. 32-33 provide immunity for persons who testify or produce evidence in response to a subpoena in connection with such an investigation. To hold that these same persons may not claim the identical privilege and immunity when their closely-held corporation is itself subpoenaed is to substitute a totally unrealistic legal fiction for the expanding spirit in which the privilege against self-incrimination has been interpreted.

The immunity provided by 15 U.S.C. secs. 32-33 should not be evaded by the device of seeking documents directly from the corporation itself that would tend to incriminate the individual appellants. As did Judge Madden in *Wild v. Brewer*, 329 F.2d 924, 925 (9th Cir. 1964) (dissenting opinion), the question of whether the corporation has the privilege against self-incrimination should be determined in reference to the test enunciated in *United States v. White*, 322 U.S. 694, 64 S.Ct. 1248, 88 L.Ed. 1542 (1944), that is, whether the organization has a "personal" character that represents the purely private or personal interests of its constituents, or whether it has such an "impersonal" character that it cannot be said to embody and represent such interests.

Since the decision of *Wild v. Brewer*, the United States Supreme Court in a number of decisions has both expanded the scope of the privilege against self-incrimination and has squarely held that the question whether an individual may claim the privilege does not turn upon any classification of the person seeking it. *Miranda v. Arizona*, 384 U.S. 436, 86 S.Ct. 1602, 16 L.Ed.2d 694 (1966), *Johnson v. New Jersey*, 384 U.S. 719, 86 S.Ct. 1772, 16 L.Ed.2d 882 (1966), *Garrity v. New Jersey*, 385 U.S., 87 S.Ct. 616, 17 L.Ed.2d

(1967), and *Spevack v. Klein*, 385 U.S., 87 S.Ct. 625, 17 L.Ed.2d (1967), require the holding that the claim of fifth amendment privilege by a corporate officer and his related immunity under the antitrust laws should not be denied simply for the reason that he holds a particular occupational classification.

While the approach of these recent Supreme Court decisions is different from that taken in *Wild v. Brewer*, it is not necessary to overrule that decision to effectively protect the interest of the individual appellants here. *Wild v. Brewer* concerned an administrative subpoena under the Internal Revenue Code, rather than a subpoena issued in the course of an antitrust investigation. There is no similar immunity in the Internal Revenue Code to that provided by 15 U.S.C. secs. 32-33. Accordingly, in *Wild v. Brewer*, no issue existed as to possible limitations that might be placed upon the use of corporate records as to individual prosecutions. The original paragraph 3 of the district court's order achieved a workable compromise between the existing state of the law as to the lack of the corporate privilege against self-incrimination and the requirement that the privilege of individuals against self-incrimination be protected by directing that the corporate records be produced, but that their use be limited to investigating possible criminal activity on the part of Maricopa Tallow Works, Inc. The district court erred, however, in granting the motion of the Government to delete this paragraph from its original order.

While the original paragraph 3 of the district court's order adequately protects the interest of the individual appellants here, the corporate appellants urge that the Court reconsider the rule that the corporation does not have the privilege against self-incrimination. Where, as here, a corporation is closely-held and for all practical purposes repre-

sents the private or personal interests of its constituents, to say that the Government may obtain records from the corporation that may then be used to prosecute them is to give effect to a legal fiction that has outlived its usefulness. Under 15 U.S.C. sec. 24, the crimes of a corporation are the crimes of the individual officers who are responsible for the acts involved.

By claiming its privilege against self-incrimination, the corporation is best able to protect the individual interests of its officers, directors and shareholders. In view of the continuing recent development of the privilege against self-incrimination, to withhold the privilege from a closely-held corporation would be to impose an unrealistic and unnecessary condition upon the exercise of the privilege that is inconsistent with the *Miranda*, *Johnson*, *Spevack*, and *Garrity* cases cited above. For these reasons, it is submitted that as to the appellant corporations, the court should adopt the analytic, fact-oriented approach formulated in *United States v. White*, *supra*, and hold that they may assert the privilege as well.

ARGUMENT

I. Introduction.

As a matter of plain realism, if there is anything in the "corporate" records which would incriminate the corporation, then necessarily it also incriminates the people who are the corporation.² If therefore these records of the corporation are turned over, it is a plain and not very appealing legal fiction to say that the individuals are not incrimi-

2. 15 U.S.C. sec. 24 provides that a violation by a corporation of any of the penal provisions of the antitrust laws is deemed also that of the directors, officers, or agents who have authorized, ordered, or done any prohibited acts. Such conduct is punishable by a fine of up to \$5,000 or by imprisonment for not exceeding one year, or both.

nated thereby. Of course they are; under the Government's interpretation of the fifth amendment and the immunity statutes, the individuals who are directly involved are, in every realistic sense, compelled to incriminate themselves without getting any immunity at all.³

We are not dealing here with some casual or merely utilitarian legal fiction, such as whether the South Sea Islands should be regarded as being in the center of London for purposes of venue.⁴ The legal fiction with which we are concerned makes a difference. People can go to jail because of it. Because of its total unrealism, this fiction has been under attack, and there has been a developing body of law that it should be abolished; we should look at the matter truthfully, for what it is, and not allow the privilege against self-incrimination to be whittled away by this deviousness. A developing body of law gives ever broader scope to the fifth amendment. We invoke this developing body of law here.

II. The Subpoena Violates the Immunity of the Individual Appellants Under 15 U.S.C. Secs. 32-33 and Invades Their Privilege Against Self-Incrimination.

15 U.S.C. secs. 32-33 expressly provide that individuals have an immunity from prosecution for antitrust violations if they are compelled to testify or produce records in re-

3. The Government perfectly freely acknowledged in the district court that it seeks to circumvent the privilege in this fashion. In its memorandum in support of motion for modification of order, the Government admitted that "in most instances the government learns of individual antitrust violations as a result of inspection of corporate documents." (R. 41).

4. For a discussion of this and other legal fictions see Hancock, *In the Parish of St. Mary le Bow, in the Ward of Cheap*, 16 Stan. L.Rev. 561, 621 (1964).

sponse to subpoena.⁵ The Government seeks to avoid the grant of that immunity by directing this subpoena solely to the appellant corporation and serving the subpoena upon its statutory agent. But the corporation is so closely held that if evidence of some wrongful activity should be found, it would necessarily and inescapably involve the individual officers, directors and shareholders. We do not have the situation presented by a large corporation, some of whose shareholders may not be directly involved in management. Here, any act charged against the corporation must necessarily also become an act charged against this small number of persons. In these circumstances, the immunity statute is evaded if the documents are taken without granting the individuals immunity who may personally be incriminated by a disclosure of their contents.

Wholly apart from the applicability of the special anti-trust immunity statute the appellants seek relief by virtue of the self-incrimination clause of the fifth amendment. If any incriminating materials should be found, they would directly incriminate the individuals as much as the corporation.

These problems have most recently concerned this court in *Wild v. Brewer*, 329 F.2d 924 (9th Cir. 1964); see also

5. 15 U.S.C. sec. 32 provides:

"No persons shall be prosecuted or be subjected to any penalty or forfeiture for or on account of any transaction, matter, or thing concerning which he may testify or produce evidence, documentary or otherwise, in any proceeding, suit, or prosecution under sections 1-7 of this title and all Acts amendatory thereof or supplemental thereto, and sections 8-11 of this title: Provided, That no person so testifying shall be exempt from prosecution or punishment for perjury committed in so testifying."

and 15 U.S.C. sec. 33 states:

"Under the immunity provisions in section 32 of this title, immunity shall extend only to a natural person who, in obedience to a subpoena, gives testimony under oath or produces evidence, documentary or otherwise, under oath."

Hyster v. United States, 338 F.2d 183 (9th Cir. 1964).⁶ In *Wild v. Brewer* the issue was whether an officer of a closely held corporation could assert his privilege against self-incrimination in opposition to an administrative subpoena directed at corporate records. There the panel (Judges Merrill, Koelsch and Madden) first held that such a privilege could be asserted, Judge Koelsch dissenting. On rehearing, Judge Merrill reversed himself and joined Judge Koelsch. 329 F.2d 924. The original opinion was withdrawn and does not appear as such in the Reporter system.⁷

In the original opinion, Judge Madden, after outlining the facts turned to the principles involved. He began with a discussion of the development of the fifth amendment privilege itself, a discussion which is far more than "historical background." As in *Wild v. Brewer*, this case is to be determined fundamentally on the basis of the attitude which the Court takes toward the fifth amendment privilege. It is either serious business, to be carried to the full extent of its logic, or it is to be "cabin'd, cribb'd, [and] confined." We adopt without repeating it the full-scale statement of Judge Madden, adding only the most recent statements of the spirit in which the Supreme Court approaches this vital part of our Constitution.⁸

6. In *Hyster*, the corporation raised contentions on behalf of its officers similar to those asserted by the individual appellants here. The Court, however, declined to reach these contentions because the officers themselves were not before it. The officers of Maricopa Tallow are parties and their claims are properly here; the Government has not cross appealed from the district court's granting of their motion to intervene.

7. The original opinion, however, was published in CCH 1964 Stand. Fed. Tax Rep. ¶ 9348 before it was withdrawn. It appears at R. 13-17.

8. In *Miranda v. Arizona*, 384 U.S. 436, 458, 86 S.Ct. 1602, 1619, 16 L.Ed.2d 694 (1966), the Court referred to the privilege against self-incrimination as "one of our Nation's most cherished

Judge Madden then turned squarely to the issue of the case. As in the instant case, the individual claimed the privilege "for himself, and says that he, and not any artificial legal entity, will be the one to suffer the punishment if he is obliged to furnish to the Government the evidence which bring about his conviction." 329 F.2d at 927.

Judge Madden fully faced the obstacles to his conclusion. *Hale v. Henkel*, 201 U.S. 43, 26 S.Ct. 370, 50 L.Ed. 652 (1906) holds that the corporation may not in its own behalf claim the privilege. This is clearly distinguishable from the claim of the individuals, and Judge Madden put it aside. *Wilson v. United States*, 221 U.S. 361, 31 S.Ct. 538, 55 L.Ed 771 (1911) does without question hold that an individual custodian of corporate books may not decline to produce the books because they might incriminate him. See also *Grant v. United States*, 227 U.S. 74, 33 S.Ct. 190, 57 L.Ed 423 (1913).

Judge Madden believed that these cases were no longer controlling. He relied in part on *United States v. White*, 322 U.S. 694, 64 S.Ct. 1248, 88 L.Ed 1542 (1944), a case involving the highly analogous problem of production of labor union records. *White* distinguished the *Wilson* and

principles," tracing the privilege to the commentary of Maimonides, who stated that "[t]he principle that no man is to be declared guilty on his own admission is a divine decree." 384 U.S. at 458, n. 27. The Court held that the fifth amendment is "fundamental to our system of constitutional rule." 384 U.S. at 468. *Malloy v. Hogan*, 378 U.S. 1, 7, 84 S.Ct. 1489, 1493, 12 L.Ed.2d 653 (1964), recognized that the development of the privilege in state cases "reflects recognition that the American system of criminal prosecution is accusatorial, not inquisitorial, and that the Fifth Amendment privilege is its essential mainstay." And, in *Murphy v. Waterfront Comm'n*, 378 U.S. 52, 55-56, 84 S.Ct. 1594, 1596-97, 12 L.Ed.2d 678 (1964), the Court enumerated in detail the "fundamental values and most noble aspirations" behind the privilege, which it characterized, quoting *Ullman v. United States*, 350 U.S. 422, 426, 76 S.Ct. 497, 500, 100 L.Ed. 511 (1956), as "one of the great landmarks in man's struggle to make himself civilized."

Grant holdings by formulating a test, as to unincorporated organizations, of

“[W]hether one can fairly say under all the circumstances that a particular type of organization has a character so impersonal in the scope of its membership and activities that it cannot be said to embody or represent the purely private or personal interests of its constituents, but rather to embody their common or group interests only.” 322 U.S. at 701.

Judge Madden found the solely-owned corporation to be one whose character was “personal” rather than “impersonal” and hence that the privilege should apply. We submit that the *White* test is applicable, that it should be applied to the present case, and that under that test, the privilege should be respected. Judge Madden relied upon the more recent cases expanding the privilege against self-incrimination and particularly upon *Ullman v. United States*, 350 U.S. 422, 76 S.Ct. 497, 100 L.Ed. 511 (1956). Judge Koelsch dissented briefly, finding the task of attempting to decide which were “personal” and which were “impersonal” holders of papers too difficult to be judicially feasible.

On rehearing, the earlier conclusion was reversed, Judge Merrill joined Judge Koelsch in the following one-sentence opinion:

“Judgment affirmed on the authority of *Grant v. United States* (1912), 227 U.S. 74, 33 S.Ct. 190, 57 L.Ed. 423, and *Wilson v. United States* (1911), 221 U.S. 361, 31 S.Ct. 538, 55 L.Ed. 771.” 329 F.2d 924, 925.

Judge Madden concluded his dissent on the rehearing:

“The recent decisions of the Supreme Court, a few of which are *Mapp v. Ohio*, 367 U.S. 643, 81 S.Ct. 1684, 6 L.Ed.2d 1081 (1961); *Gideon v. Wainwright*, 372 U.S. 335, 83 S.Ct. 792, 9 L.Ed. 2d 799 (1963); *National*

Association for the Advancement of Colored People v. Button, 371 U.S. 415, 83 S.Ct. 328, 9 L.Ed.2d 405 (1963); *Massiah v. United States*, 84 S.Ct. 1199 (1964), seem to me to make this court's decision in the instant case anachronistic." 329 F.2d at 929.

The problem of *Wild v. Brewer* was, concededly, marginal; this Court would not have had difficulty with it going first one way and then the other, if the question had not been genuinely troublesome; and so with the trial court in the instant case, which by odd parallelism has now ruled both ways on the underlying question.⁹ But the doubts which existed in 1964 are largely set at rest by later judicial development. It is not useful to decide whether *Wild v. Brewer* was "anachronistic" as Judge Madden said in 1964, for clearly the rule it applies is indeed an anachronism today. The fundamental question is whether John Doe, citizen loses all of the fifth amendment rights worth having when he becomes John Doe, Inc. Legal developments subsequent to *Wild v. Brewer* resist any such conclusion.

9. Other courts have also had difficulty reconciling the established body of law concerning the corporate officer's lack of privilege with the more recent cases in closely related areas that have extended the privilege against self-incrimination. In *Hair Industry, Ltd. v. United States*, 340 F.2d 510, 511 (2d Cir. 1965), a case involving a claim of privilege by the sole owner of a corporation, the court found "some appeal" to the argument that the individual owner should be able to claim the privilege under the *White* principle, and that form should yield to substance, but felt itself bound by *Hale v. Henkel*, *supra*. And, in *Wright v. Detwiler*, 241 F.Supp. 753 (W.D.Pa. 1964), another case involving the claim of privilege by an officer of a family-owned corporation, Judge Willson recognized that "it may be that some of [the earlier] . . . decisions should no longer be followed in view of the present tendency to grant to individuals the widest protection under the . . . [Fourth and Fifth] amendments," but felt himself, as a district judge, bound by the existing rule.

For commentary critical of the result reached by the majority in *Wild v. Brewer*, see 78 Harv. L.Rev. 455 (1964); 49 Minn. L.Rev. 311 (1964); 39 N.Y.U.L. Rev. 1118 (1964); 51 Va. L.Rev. 143 (1965) (these comments are included in the record at R. 77-103).

This term the Supreme Court has decided three cases, *Garrity v. New Jersey*, 385 U.S., 87 S.Ct. 616, 17 L.Ed.2d (1967), and *Spevack v. Klein*, 385 U.S., 87 S.Ct. 625, 17 L.Ed. 23 (1967), and *Application of Gault*, (U.S. S.Ct. May 15, 1967) (not yet reported), which bear directly on the question of the claimed privilege by the individual officers and shareholders in the present case. In *Garrity* the Court reversed convictions based on statements obtained from defendant police officers who were told that if they refused to answer questions they would be subject to removal from office. In *Spevack*, the Court held that a lawyer who refused to honor a subpoena duces tecum served on him to produce financial records could not for that reason be disbarred, overruling *Cohen v. Hurley*, 366 U.S. 117, 81 S.Ct. 954, 6 L.Ed. 2d 156 (1961). In *Application of Gault* the Court held that the privilege against self-incrimination extends to juvenile proceedings, rejecting the argument that the privilege could be denied to persons having the status of juveniles, and focusing instead in a functional manner upon the nature of the statement given and the exposure it invites. These decisions have added an entirely new dimension to the scope of the privilege against self-incrimination.

These cases were prefaced by the landmark decision in *Miranda v. Arizona*, 384 U.S. 436, 86 S.Ct. 1602, 16 L.Ed. 2d 694 (1966). While that case deals in a narrow sense with in-custody interrogation by police officers in a station house, broad statements were made concerning the privilege against self-incrimination that are also applicable here. In *Miranda* the Court held that "The privilege against self-incrimination secured by the Constitution applies to all individuals."

In a later passage in the *Miranda* opinion, the Court considered the "recurrent argument" that "society's need for interrogation outweighs the privilege" against self-incrimination. 384 U.S. at 479.

The Court categorically rejected that argument, holding flatly that "the Constitution has prescribed the rights of the individual when confronted with the power of government when it provided in the fifth amendment that an individual cannot be compelled to be a witness against himself. That right cannot be abridged." 384 U.S. at 479. These statements of the Court in *Miranda* were reinforced by the decision in *Johnson v. New Jersey*, 384 U.S. 719, 86 S.Ct. 1772, 16 L.Ed.2d 882 (1966), which held that "our opinion in *Miranda* makes it clear that the prime purpose of these rulings [in *Escobedo* and *Miranda*] is to guarantee full effectuation of the privilege against self-incrimination, the mainstay of our adversary system of criminal justice." 384 U.S. at 729.

Following this broad enunciation of principles in *Miranda* and *Johnson*, the *Spevack*, *Garrity* and *Gault* cases have significance beyond the facts presented there. The thrust of these opinions is that by merely taking on a particular status, such as that of a lawyer or a policeman, the individual citizen does not thereby forfeit the privilege against self-incrimination that he formerly possessed as an individual. In *Spevack*, the Court held that the person who exercises this privilege should suffer no penalty for his silence, and that the definition of penalty is not restricted to fine or imprisonment. Following *Griffin v. State of California*, 380 U.S. 609, 85 S.Ct. 1229, 14 L.Ed.2d 106 (1965), the Court held that the assertion of the fifth amendment privilege may not be made costly to the person claiming it and, following *Miranda*, it held that:

"In this Court, the privilege has consistently been accorded a liberal construction. . . . We find no room in the privilege against self-incrimination for classifications of people so as to deny it to some and extend

it to others. Lawyers are not excepted from the words 'No person . . . shall be compelled in any criminal case to be a witness against himself'; and we can imply no exception. Like the school teacher in *Slochower v. Board of Higher Education of City of New York*, 350 U.S. 551, 76 S.Ct. 637, 100 L.Ed. 692, and the policeman in *Garrity v. State of New Jersey*, 385 U.S. . . ., 87 S.Ct. 616, 17 L.Ed.2d . . ., lawyers also enjoy first-class citizenship." 87 S.Ct. at 628-29.

In *Garrity* the issue was whether statements obtained when the defendant officers were presented with a choice of self-incrimination or job forfeiture were admissible as evidence of guilt. Such pressure was held likely to " 'disable . . . [the officers] from making a free and rational choice, [citing *Miranda*], ' " and that confessions obtained in such a manner "were infected by the coercion inherent in this scheme of questioning and [could] . . . not be sustained as voluntary." 87 S.Ct. at 618-19.

In the present case, the individual appellants have chosen to conduct their business in a corporate form. This choice, however, does not in any way depersonalize the personal concern they have had with the conduct of their business, the personal responsibility that they have for its successful management, and the criminal responsibility that they have for its violation of the antitrust laws. To hold that by choosing to do business in a corporate form an individual thereby waives his privilege against self-incrimination is to give him the choice "between the rock and the whirlpool," *Garrity v. New Jersey*, 87 S.Ct. at 619, and when that occurs, "duress is inherent in deciding to 'waive' one or the other." *Id.*¹⁰ Under the reasoning of *Garrity* and *Spevack*,

10. See also *Frost v. Railroad Comm'n*, 271 U.S. 583, 46 S.Ct. 605, 70 L.Ed. 1101 (1926). For a general discussion anticipating the result in *Garrity* and *Spevack* see Note, *Unconstitutional Conditions*, 73 Harv. L.Rev. 1595 (1960).

appellants should not be required to forego doing business in a corporate form to retain their fifth amendment privilege, and, where they have undertaken business in this form, their privilege should be protected by limiting the scope in which the materials obtained from the corporation may be used. Corporate officers, in the same manner as lawyers, teachers, and policemen, should also be held to be "first-class citizens."

In its most recent decision, *Application of Gault*, (U.S.S.Ct. May 15, 1967) (not yet reported) the Court has extended the privilege against self-incrimination to juvenile court proceedings. In that case, the Court again refused to limit the scope of the privilege because of the status of the person claiming it, and specifically held that the privilege against self-incrimination is unequivocal, without exception, and comprehensive. The opinion holds:

"It would indeed be surprising if the privilege against self-incrimination were available to hardened criminals but not to children. The language of the Fifth Amendment applicable to the States by operation of the Fourteenth Amendment, is unequivocal and without exception. And the scope of the privilege is comprehensive.

". . . It is also clear that the availability of the privilege does not turn upon the type of proceedings in which its protection is invoked, but upon the nature of the statement or admission and the exposure it invites . . .

". . . It would be entirely unrealistic to carve out of the Fifth Amendment all statements by juveniles on the ground that these cannot lead to 'criminal' involvement . . .

". . . [O]ur Constitution guarantees that no person shall be 'compelled' to be a witness against himself when he is threatened with deprivation of his liberty—a command which this Court has broadly applied and generously implemented in accordance with the teach-

ing of the history of the privilege and its great office in mankind's battle for freedom . . .¹¹

"We conclude that the constitutional privilege against self-incrimination is applicable in the case of juveniles as it is with respect to adults." 27 U.S.S.Ct. Bull. B. 1677, 1720-28.

All of the reasons given by the Court in *Gault* for extending the privilege against self-incrimination to juveniles apply equally to corporate officers. This most recent opinion gives further confirmation of the trend of the recent Supreme Court decisions that have made the holdings in *Wilson v. United States*, *supra*, and *Grant v. United States*, *supra*, obsolescent and of appellants' contention that no exceptions may be carved out of the broad protections afforded by the fifth amendment.

In order for this Court to reach the result required by *Spevack* and *Garrity* with respect to the protection of the individual privilege against self-incrimination in the context of an antitrust prosecution, it is not necessary to overrule *Wild v. Brewer*. That decision may be distinguished for the following reasons. *Wild v. Brewer* concerned an administrative subpoena under 26 U.S.C. sec. 7602. The Internal Revenue Code provides no immunity similar to that provided by 15 U.S.C. sec. 32-33 for corporate officers who produce corporate records in response to such a subpoena. Therefore, in *Wild v. Brewer*, the question presented was whether the taxpayer's records must be produced under any and all circumstances, without limitation as to use. Because of the absence of any immunity statute similar to 15 U.S.C. sec. 32-33, there was no issue in the case of limita-

11. See, e.g., *Miranda v. Arizona*, 384 U.S. 436 (1966); *Garrity v. New Jersey*, 385 U.S. 493 (1967); *Spevack v. Klein*, 385 U.S. 511 (1967); *Haynes v. Washington*, 373 U.S. 503 (1963); *Culombe v. Connecticut*, 367 U.S. 568 (1961); *Rogers v. Richmond*, 365 U.S. 534 (1961); *Malloy v. Hogan*, 378 U.S. 1 (1964); *Griffin v. California*, 380 U.S. 609 (1965). (Footnote by the Court).

tions that might be put upon the use of the records required to be produced.

In the present case, however, the fifth amendment privilege of the individual officers, directors and shareholders would be to a large extent protected by a limitation on the use to which the corporate records might be put, in the manner prescribed by the original order of the district court. This order required that the corporate records be produced. To that extent, it is not inconsistent with *Wild v. Brewer*. But the order further provided that:

“[T]hese materials may only be used for purposes of investigating possible criminal activity on the part of Maricopa Tallow Works, Inc. and may not be used for the purpose of investigating any possible criminal activity on the part of any of the above named individuals [the individual appellants here].” (R. 35-36)

As noted in the Statement of Facts portion of this brief, at the time of the argument on the motion to quash appellants urged, the Government conceded, and the court agreed that the proposed limitation on the use to which the corporate records might be put was not within the scope of *Wild v. Brewer*, and that this limitation could be placed upon such use consistent with that decision.

The original paragraph 3 of the district court's order achieved a workable compromise between the existing state of the law as to the lack of corporate privilege against self-incrimination and the requirement that the privilege of individuals against self-incrimination be protected. Further, the original paragraph 3 of the district court's order is not inconsistent with *Wild v. Brewer*, and for that reason, in the event that this Court holds that the corporation itself does not possess a privilege against self-incrimination, appellants respectfully submit that the third paragraph of this order should be reinstated.

III. The Subpoena Should Be Quashed Because It Invades the Corporation's Privilege Against Self-Incrimination.

Appellants are aware of substantial authority as to the applicability of the privilege against self-incrimination to corporations. They nonetheless present this phase of the matter to perfect their record. They expressly challenge the soundness of the authority of the cases of *Hale v. Henkel*, 201 U.S. 43, 26 S.Ct. 370, 50 L.Ed. 652 (1906); *Wilson v. United States*, 221 U.S. 361, 31 S.Ct. 538, 55 L.Ed. 771 (1911), and the cases following them to the extent they hold that a closely-held corporation does not have such a privilege, for the reason that such holdings represent a hostile interpretation of the privilege against self-incrimination that is out of keeping with the broad policy considerations that were responsible for its formulation and enactment. See generally *Ullman v. United States*, 350 U.S. 422, 76 S.Ct. 497, 100 L.Ed. 511 (1956); *Wilson v. United States*, 221 U.S. 361, 392, 31 S.Ct. 538, 55 L.Ed. 771 (1911) (dissenting opinion of Mr. Justice McKenna); *Miranda v. Arizona*, 384 U.S. 436, 86 S.Ct. 1602, 1619-21, 16 L.Ed. 2d 694 (1966). The Court is urged to reconsider this authority and to hold that the privilege against self-incrimination should extend to a closely-held corporation such as Maricopa Tallow Works, Inc. applying the test formulated in *United States v. White*, 322 U.S. 694, 64 S.Ct. 1248, 88 L.Ed. 1542 (1944), of whether the corporation embodies or represents the private or personal interests of its constituents or whether it embodies only their group interests in an impersonal way. For a recent case applying and articulating the *White* test as related to a closely-held partnership, see *United States v. Cogan*, 257 F.Supp. 170 (S.D.N.Y. 1966).

In view of the *Sperack* and *Garrity* decisions, the question of whether a closely-held business operates in corporate form so as to deny the privilege against self-incrimina-

tion to its officers and shareholders is no longer the controlling inquiry. *Miranda* and *Johnson* stand for the principle that a fully effectuated privilege against self-incrimination extends to all individuals. *Spevack* and *Garrity* together hold that merely by assumption of a particular occupational status a person does not thereby relinquish his privilege against self-incrimination, and that a person who has chosen a particular occupation does not thereby become a second-class citizen under the Constitution. Such a result in a federal prosecution would be in conflict with the due process clause of the fifth amendment. *Cf. Bolling v. Sharpe*, 347 U.S. 497, 74 S.Ct. 693, 98 L.Ed. 884 (1954). As pointed out by Judge Madden in *Wild v. Brewer*.

“[T]he impliedly reserved visitatorial power of the state which created the artificial legal entity, which power somehow is transferred to the Federal Government, seems to me to be something of a make-weight in the cases in which it has been expressed. And I think that the argument that one who incorporates his business has only himself to blame if he thereby forfeits Constitutional rights is not of Constitutional weight.” 329 F.2d at 928.

When the above recent Supreme Court cases are taken together with 15 U.S.C. Sec. 24, which makes the crimes of a corporation the crimes of the individual officers who are responsible, and with the realization that any fine or penalty paid by a corporation must necessarily ultimately be paid by the responsible officers and shareholders, the reasons previously given for refusing the privilege of self-incrimination to closely-held corporation should no longer be controlling. Not only does the corporation have an interest in asserting the privilege on behalf of its officers, it has the interest on its own behalf of asserting the privilege, since by doing so the greatest protection is afforded to the

individual officers, directors and shareholders; for fifth amendment purposes, it is the officers, directors, and shareholders. To say that the creation of an artificial entity for the purposes of doing business thereby forfeits the privilege against self-incrimination that the entity and responsible individuals would otherwise have is to impose an unrealistic and unnecessary condition upon the exercise of the privilege that is inconsistent with *Miranda*, *Johnson*, *Spevack*, and *Garrity*. For these reasons, it is submitted that *Hale v. Henkel*, *Wilson v. United States*, and the cases following them should no longer be deemed controlling by this Court, and that the Court instead should adopt the analytic, fact-oriented, approach formulated in *United States v. White*, *supra*, as applied to closely-held corporations.

CONCLUSION

It is respectfully submitted that the decision of the court below should be reversed.

LEWIS ROCA SCOVILLE

BEAUCHAMP & LINTON

By JOHN P. FRANK

JOHN J. FLYNN

PAUL G. ULRICH

Attorneys for Appellants

May, 1967

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

PAUL G. ULRICH

No. 21,802

IN THE UNITED STATES COURT OF
APPEALS FOR THE NINTH CIRCUIT

MARICOPA TALLOW WORKS, INC., W. J. GIESZL, THOMAS E. LEWIS,
NED LEWIS, T. L. BERGEN, ROBERT L. POER, AND ANAHEIM CITRUS
PRODUCTS CO., INC., APPELLANTS,

v.

UNITED STATES OF AMERICA, APPELLEE

BRIEF FOR APPELLEE

DONALD F. TURNER
Assistant Attorney General

RICHARD C. GORMLEY
United States Attorney
Phoenix, Arizona

HOWARD E. SHAPIRO
THOMAS R. ASHER,
Attorneys,

Department of Justice
Washington, D.C. 20530

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IN THE UNITED STATES COURT OF
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No. 21,802

MARICOPA TALLOW WORKS, INC., W. J. GIESZL, THOMAS E. LEWIS,
NED LEWIS, T.L. BERGEN, ROBERT L. POER, AND ANAHEIM CITRUS
PRODUCTS CO., INC., APPELLANTS,

v.

UNITED STATES OF AMERICA, APPELLEE

BRIEF FOR THE UNITED STATES OF AMERICA

STATEMENT

Appellants' statement of the case is substantially correct,
except as follows:

At page 2 of their brief appellants state that the subpoena
in question directed "that certain designated corporate records
be produced for Grand Jury inspection purposes." On the next
page, they assert that the subpoena demanded "numerous personal
papers which were not records of the corporation." The first of
these two statements is correct --i.e. no personal papers were
demanded and the subpoena was directed solely to the corporation,
Maricopa Tallow Works, Inc. (hereafter referred to as "Maricopa").
In addition, the district court's order of December 6, 1966 ex-
cluded from the scope of the subpoena all "personal papers,
records, and documents" of the individual appellants, as well as

"documents held by them in a personal capacity." (R. 35).

In its order of December 6, 1966, the district court had also included the following restrictive provision:

"3. With respect to the materials furnished to the Grand Jury by reason of the subpoena heretofore issued, it is ordered that these materials may only be used for purposes of investigating possible criminal activity on the part of Maricopa Tallow Works, Inc. and may not be used for the purpose of investigating any possible criminal activity on the part of any of the above named individuals [appellants]." (R. 35-36).

But this paragraph was stricken by the court's amended order of February 8, 1967 on the government's motion for modification. The Government's memorandum supporting its motion for modification cited the Supreme Court cases discussed, infra, as well as Wild v. Brewer, 329 F. 2d 924 (C.A. 9), certiorari denied 379 U.S. 914. Contrary to appellants' assertion (Brief, p. 5), the appellee-United States never acknowledged or conceded that Wild v. Brewer is not controlling of the facts in this case. During the argument on appellant's motion to quash the subpoena, government counsel simply recognized that the fact of Wild v. Brewer did not involve a restrictive provision like that quoted above. ^{1/}

^{1/} MR. FLYNN, Counsel for Appellant: Yes, but they have not granted immunity under the cases until they begin to inquire of the individual about the contents of the books and records, and then the immunity attaches. And so this again is how they
(Continued next page.)

QUESTIONS PRESENTED

1. Whether the district court's order refusing to quash or modify the grand jury subpoena duces tecum issued to Maricopa Tallow Works Inc., is appealable as a final decision under 28 U.S.C. 1291.

2. Whether corporate documents subpoenaed by a grand jury can be immunized from disclosure or limited in use by the grand jury on the ground that they may incriminate individuals connected with the corporation, or the corporation itself.

SUMMARY OF ARGUMENT

The Supreme Court of the United States has unequivocally defined the law relevant to both of the questions in this case, and in each instance has ruled that appellants' position

1/ Footnote continued from preceding page.
avoid this question of immunity from self-incrimination and yet get an indictment against the individual. That's why we are urging upon the Court limitation of the use of the books and records themselves.

Mr. Rosenstein: Your Honor, may I respond very briefly to that?

The Government strongly resists an order to that effect, of course, and we base that resistance on two Supreme Court cases which I read, U.S. vs. White and Rogers vs. United States, which squarely hold that if these are corporate records and they incidentally incriminate the keepers, the custodians, they still must be produced. That is the state of the law at present.

In addition, the Wild vs. Brewer case specifically holds that-- on page 927, and that's a 9th Circuit case. And on that basis the Government contends that such an order be erroneous under the state of the law today.

THE COURT: Wait a minute. Wait a minute.
There wasn't any such order in any one of those cases, was there?

Mr. Rosenstein: No.

THE COURT: We don't know it, do we?

Mr. Rosenstein: Well, all right. [Transcript of Hearing on Motion to Quash Subpoena Duces Tecum, December 6, 1966, pp. 20-22.]

is without merit. Cobbledick v. United States, 309 U.S. 323, held that an order denying a motion to quash a grand jury subpoena is not a final order and therefore not appealable. The exception to this rule where the subpoena demands material subject to a claim that it is privileged as the work product of an attorney, Perlman v. United States, 247 U.S. 7, Continental Oil Co. v. United States, 330 F.2d 347, is not applicable to the facts of this case.

That the Fifth Amendment privilege against self-incrimination is unavailable when documents are subpoenaed from a corporation is well established by the Supreme Court. See Hale v. Henkel, 201 U.S. 43, and Wilson v. United States, 221 U.S. 361. Not only is the corporation without a privilege against self-incrimination, but the law is clear that shareholders, officers, directors, and employees of a corporation cannot claim the privilege — which applies only to their personal papers — as to corporate documents.

ARGUMENT

1. THE DISTRICT COURT'S ORDER REFUSING TO QUASH OR MODIFY THE GRAND JURY SUBPOENA DUCES TECUM ISSUED TO MARICOPA TALLOW WORKS, INC., IS NOT APPEALABLE BECAUSE NOT A FINAL DECISION UNDER 28 U.S.C. 1291.

On May 19, 1967, the United States moved this court to dismiss this appeal, or in the alternative for summary affirmance.² /

In summary, the motion to dismiss the appeal is based upon Cobbledick v. United States, 309 U. S. 323 (1940). In that case the Supreme Court was faced with the question of "whether an order denying a motion to quash a subpoena duces tecum directing a witness to appear before a grand jury is included within those 'final decisions' in the district court which alone the circuit courts of appeal are authorized to review" (309 U.S. at 324). The court held that the order was not an appealable "final decision". It emphasized policy against piecemeal appellate review and against any "undue interruption of the inquiry instituted by a grand jury" (309 U.S. at 327). The Court noted that its ruling did not deprive the person opposing the subpoena of appellate review because they could challenge or appeal final orders imposing sanctions for disobeying the subpoena.

Appellants responded to the government's motion to dismiss

² / The alternative motion is based upon this Court's decision in Wild v. Brewer, 329 F. 2d 924, certiorari denied 379 U.S. 914, which completely disposes of appellants' arguments herein. Argument on that question is contained infra.

by citing this Court's decision in Continental Oil Co. v. United States, 330 F.2d 347, as expressly sustaining appealability. The government filed a reply memorandum which illustrated that the Continental Oil case involved an exception to the Cobbledick rule not here relevant — the attorney's work product privilege. A line of cases discussed by this Court in Continental Oil (Perlman v. United States, 247 U.S. 7; Schwimmer v. United States, 232 F. 2d 855 (8 Cir.)), permits appeal because of the strong public policy against forcing an attorney on behalf of his client to run the risk of a contempt citation. See Hickman v. Taylor, 329 U.S. 495, 512. (Hickman was also cited in Continental.)

This is not a case in which documents are demanded of a lawyer, nor one where the attorney — client privilege or work product privilege is claimed. Continental Oil is therefore inapplicable and Cobbledick requires dismissal of the appeal.

2. CORPORATE DOCUMENTS SUBPOENAED BY A GRAND JURY CANNOT BE IMMUNIZED FROM DISCLOSURE OR LIMITED IN USE BY THE GRAND JURY ON THE GROUND THAT THEY MAY INCRIMINATE INDIVIDUALS CONNECTED WITH THE CORPORATION, OR THE CORPORATION ITSELF.

Anaheim Citrus Products Co., Inc. and the individual appellants as stockholders and officers of Maricopa argue that the corporate documents subpoenaed from Maricopa may tend to incriminate them. In addition Maricopa, a corporation, contends

that it has a privilege against self-incrimination. In reliance upon these arguments of constitutional privilege, appellants urge that the district court erred in refusing to quash the subpoena and in modifying its order of December 6, 1966 by striking from it the provision (¶3) precluding the grand jury from using documents produced under the subpoena for investigating criminal activity on the part of appellants other than Maricopa. In the alternative, they argue that the antitrust immunity statute, 15 U.S.C. 32-33, grants them immunity from prosecution. We show below that neither of these contentions have merit.

Appellants acknowledge that the current law, as enunciated by Supreme Court decisions, limits the privilege against self-incrimination to natural persons (Appellants' brief, p. 14) --i.e., a corporation has no such privilege, Hale v. Henkel, 201 U.S. 43, and production of documents belonging to a corporation may not be resisted because they may tend to incriminate anyone, Wilson v. United States, 221 U.S. 361. Despite the clarity of these holdings, appellants urge that this court overrule them in the light of numerous recent holdings by the Supreme Court that the privilege against self-incrimination is fundamental to a free and libertarian society. 3 / None of these decisions question

3 / E.g. Malloy v. Hogan, 378 U.S. 1; Ullman v. United States, 350 U.S. 422; Spevack v. Klein, 385 U.S. 511; Garrity v. New Jersey, 385 U.S. 493. None of these cases involved corporate documents. Each involved a natural person claiming the privilege on his own behalf.

the validity of Hale v. Henkel and Wilson and cases following them, and no decision of the Supreme Court furnishes any support for the contentions urged by appellants. The Supreme Court has never questioned the principle that self-incrimination is a privilege personal to individuals, which cannot be invoked to bar the evidence of another, and which cannot be claimed at all by corporations.

Only three years ago, this Court applied these principles. In Wild v. Brewer, 329 F. 2d 924 (C.A. 9) certiorari denied 379 U. S. 914, the sole stockholder of a corporation resisted the production of his corporation's documents demanded by the government because they might tend to incriminate him. The identity of interest between the corporation and the person claiming the privilege was almost total.^{4/} Yet this Court correctly held that the stockholder's claim of self-incrimination could not be invoked to prevent the production of a corporation's documents. Appellants urge that United States v. White, 322 U. S. 694, a Supreme Court decision post-dating Hale v. Henkel and Wilson, questions the validity of those cases and suggests a new standard whereby small, closely held corporations are within the ambit of the self-incrimination privilege, or,

^{4/} It should be noted that this is not so in the instant case. Among Maricopa's several shareholders is another corporation with an unknown number of shareholders.

rather, that their owners and officers may claim the privilege as to corporate documents. This is simply not so. White involved a grand jury investigative subpoena directed to a labor union, demanding union documents. The union official in possession of the documents declined to produce them, claiming that they might tend to incriminate him. The district court rejected his claim, and after he refused to produce the union documents he was convicted of contempt. The Supreme Court sustained the conviction, holding that, although the union, unlike a corporation, did not have a legal existence beyond that of its members, it was such a large and extensive organization that it, in fact, had an existence of its own. ^{5/} Thus, its officials, like the officers of a corporation, could not validly claim their personal self-incrimination privilege as to the organization's documents. The Court in White stressed that the privilege is not available to corporations and not applicable to corporate documents:

"Nor do we question the obvious fact business corporations, by virtue of their creation by the state and because of the nature and purpose of their activities, differ in many significant respects from unions, religious bodies, trade associations, social clubs and other types of organizations, and accordingly owe different obligations to the federal and state governments. (322 U.S. at 697-8): . . . Since the privilege against self-incrimination is a purely personal one, it

^{5/} "Structurally and functionally, a labor union is an institution which involves more than the private or personal interests of its members. It represents organized, institutional activity as contrasted with wholly individual activity." (322 U. S. at 701.)

cannot be utilized by or on behalf of any organization, such as a corporation. Hale v. Henkel, 201 U.S. 43; Wilson v. United States, 221 U.S. 361; Essgee Co. v. United States, 262 U.S. 151. See also United States v. Invader Oil Corp., 5 F.2d 715. Moreover, the papers and effects which the privilege protects must be the private property of the person claiming the privilege, or at least in his possession in a purely personal capacity. Boyd v. United States, 116 U.S. 616. But individuals, when acting as representatives of a collective group, cannot be said to be exercising their personal rights and duties nor to be entitled to their purely personal privileges. Rather they assume the rights, duties and privileges of the artificial entity or association of which they are agents or officers and they are bound by its obligations. In their official capacity, therefore, they have no privilege against self-incrimination. And the official records and documents of the organization that are held by them in a representative rather than in a personal capacity cannot be the subject of the personal privilege against self-incrimination, even though production of the papers might tend to incriminate them personally. Wilson v. United States, *supra*; Dreier v. United States, 221 U.S. 394; Baltimore & Ohio R. Co. v. Interstate Commerce Commission, 221 U.S. 612; Wheeler v. United States, 226 U.S. 478; Grant v. United States, 227 U.S. 74; Essgee Co. v. United States, *supra*. . . . They therefore embody no element of personal privacy and carry with them no claim of personal privilege. (322 U.S. at 699-700) (Emphasis added.)

Thus, the "White test", so often cited by appellants as the proper standard with which to measure their appeal, is squarely against them. White held that when an organization without a state-chartered legal existence is so institutional in nature that its interests can be said to be independent of the individual interests of its members, then those members cannot claim their personal privilege against self-incrimination to resist production of documents belonging to the organization. A corporation, since it is chartered as a body with independent

legal existence, always lies outside of the privilege. The validity of this rule has never been questioned by the Supreme Court and is controlling here.

Appellants gain no help from the statutes which grant immunity from prosecution to corporate officers and directors required to testify as individuals before a grand jury investigating possible violations of the antitrust laws. 15 U.S.C. §§32-33. In Heike v. United States, 227 U.S. 131, it was held that the statutes are coextensive with the Constitutional privilege against self-incrimination. Thus, immunity attaches only when a corporate officer or director is required to disclose information or documents as to which he might otherwise make a valid claim of the Fifth Amendment privilege. See Kronick v. United States, 343 F. 2d 436(C.A. 9). Since paragraph 2 of the district court's order excludes from the scope of the subpoena all purely personal documents of the individual appellants, their Fifth Amendment rights have been fully protected. United States v. White, *supra*; Wilson v. United States, *supra*; Rogers v. United States, 340 U. S. 367. Appellants are thus without statutory immunity and their arguments based upon claims of immunity are invalid.

Appellants assert that the district court erred in striking the third paragraph of its original order. That paragraph barred the grand jury from utilizing the corporate documents produced in compliance with the subpoena to investigate any



of the individual appellants. The practical effect of such a provision would be to shut the grand jury's eyes to relevant, unprivileged evidence of possible wrong-doing by Maricopa's officers and stockholders. As noted above, the privilege against self-incrimination is personal to individuals. It cannot be claimed to prevent another from testifying. Thus an accused person may stand silent, but he cannot require other witnesses with knowledge of his wrong-doing to do so. Were it otherwise, the privilege against self-incrimination would become a privilege against any incrimination. Here, the evidence of the other witnesses is contained in corporate documents subpoenaed from Maricopa. Appellants can no more suppress this under their privilege against self-incrimination than they could bar live testimony by other persons before the grand jury or before a court.

In most instances the government learns of individual anti-trust violations as the result of inspection of corporate documents. If the information obtained from these documents cannot be used to prosecute officers and directors of the corporation, those officers have in essence been granted an immunity far in excess of that required by the statute, 15 U.S.C. §§32-33, supra. This result is contrary not only to the purposes of the antitrust laws but improperly restricts the discretion of the grand jury to investigate possible criminal activities. As stated by the Supreme Court in United States v.

Thompson, 251 U.S. 407, 413:

[T]he power and duty of the grand jury to investigate is original and complete, susceptible of being exercised upon its own motion and upon such knowledge as it may derive from any source which it may deem proper, and is not therefore dependent for its exertion upon the approval or disapproval of the court.

Therefore, the district court properly excised ¶ 3 of its original order.

Appellants ask this court to overrule a line of Supreme Court cases which has been unquestioned by that Court for 60 years by finding that a corporation can claim the Fifth Amendment privilege against self-incrimination and that officers and shareholders of a corporation can claim the privilege as to the corporation's documents. This Court properly refused to so rule in Wild v. Brewer, supra, and should not do so in this case.

CONCLUSION

This appeal should be dismissed; if not, the decision of the district court should be affirmed.

Respectfully submitted.

DONALD F. TURNER
Assistant Attorney General

RICHARD C. GORMLEY
United States Attorney
Phoenix, Arizona

HOWARD E. SHAPIRO
THOMAS R. ASHER,
Attorneys,

Department of Justice,
Washington, D.C. 20530

JULY 1967

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Thomas R. Asher

Washington,

District of Columbia

Thomas R. Asher, being duly sworn deposes and says:

1. I am an attorney with the Department of Justice, Antitrust Division, Appellate Section, in Washington, D.C., and am counsel for the United States in this case.

2. On July , , 1967, I caused to be served, by United States Air Mail, the foregoing brief of the United States upon: .

Lewis, Roca, Scoville, Beauchamp
& Linton
Attorneys at Law
114 West Adams Street
Phoenix, Arizona

Attorneys for Appellants.

Thomas R. Asher
Attorney for Appellee

Sworn to before me

this ____ day of July, 1967.

Notary Public

RECEIVED

NOV 9 1967

No. 21802

In the

WM. B. LUCK, CLERK
United States Court of Appeals

For the Ninth Circuit

MARICOPA TALLOW WORKS, INC.,
W. J. GIESZL, THOMAS E. LEWIS,
NED LEWIS, T. L. BERGEN,
ROBERT L. POER, and ANAHEIM
CITRUS PRODUCTS, INC.,

Petitioners,

vs.

UNITED STATES OF AMERICA,
Respondent.

FILED
NOV 9 1967
WM. B. LUCK, CLERK

PETITION FOR REHEARING

LEWIS ROCA BEAUCHAMP &
LINTON

By John P. Frank

John J. Flynn

Paul G. Ulrich

114 West Adams Street
Phoenix, Arizona 85003

Attorneys for Petitioners

NOV 9 - 1967

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No. 21802

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vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR REHEARING

The petitioners in the above entitled cause, by and through their attorneys undersigned, respectfully petition the Court to rehear en banc the matters determined by the Court's order of October 13, 1967, denying petitioners' application for a writ of mandamus. The following grounds support this petition.

1. The issue presented by the appeal from the District Court's order¹ denying a motion to quash a grand jury subpoena duces

¹Although the order appealed from was held not to be appealable under 28 U.S.C. Sec. 1291, this Court, in its opinion of August 16, 1967, denied the Government's motion to dismiss the appeal and considered the appeal as a petition for a writ of mandamus because of the "substantial question which the appellants are entitled to have decided." Opinion, p. 2.

tecum in an antitrust investigation of the Arizona tallow industry is whether the officers, shareholders and directors of a closely-held corporation, who are in actual close personal contact with the matters called for by the subpoena and with the day-to-day operation of the corporation, can assert their own personal privilege against self-incrimination as to the production of documents which may, as a practical matter, incriminate them personally.² The subpoena itself calls for numerous documents³ indicating that the Government seeks by this means to establish the extent of participation in the corporation's pricing and marketing decisions by all individuals connected with it. This question necessarily involves the weight and effect to be given *Wild v. Brewer*, 329 F. 2d 924 (9th Cir. 1964), which held that the Fifth Amendment privilege against self-incrimination was not available to a solely owned corporation with respect to its records and papers so as to prevent compliance with an administrative Internal Revenue subpoena. Since this case arises in the context of an antitrust investigation, rather than an Internal Revenue investigation, different statutes are involved and *Wild v. Brewer* is distinguishable.⁴ In a broader

²The affidavit of Thomas E. Lewis (R. 11-12) shows that only two persons conduct the day-by-day administration of the corporation, that there are only three officers and three individual shareholders, together with another corporation owning less than 25% of Maricopa's stock, and that there are only four directors of the corporation.

³Documents are defined by the subpoena as originals and copies of all correspondence, memoranda or minutes, bulletins, inter-office communications, recordings or telephone conversations, meetings and conferences, reports, books of account, notes of personal conversations or meetings or telephone conversations owned by or in possession of the addressee relating to the persons responsible for pricing policy of the corporation, how prices are established, all cost studies and work sheets relating to prices charged, and all documents pertaining to the division and allocation of markets and stabilization of prices, together with desk diaries, appointment books, expense accounts, and memoranda of conversations with representatives of any other rendering company (R. 29-34).

⁴Two antitrust immunity statutes, 15 U.S.C. Secs. 32-33, prevent prosecution or the subjection to any penalty or forfeiture of a witness on account of any transaction, matter, or thing concerning which he may testify or produce evidence, documentary or otherwise, in a proceeding before

sense, however, the question presented by the petition following the District Court's order is whether, since the decision of a number of recent cases by the Supreme Court of the United States, the decision in *Wild v. Brewer* should stand, on the basis of strict Fifth Amendment analysis.

2. During the last five years, the Supreme Court of the United States has decided a number of cases, with increasing frequency, that establish the concept of guaranteeing constitutional protections in a practical, realistic manner. These decisions, set forth in detail in petitioners' brief, show that the Court has overruled the arbitrary distinctions in this area as to the availability of the guarantee based on the class of person involved that had formerly constituted an obstacle to the claim of privilege.⁵ Within the past six months, two other such cases have been decided by the Su-

the grand jury. 15 U.S.C. Sec. 24 provides that a violation by a corporation of any of the penal provisions of the antitrust laws is deemed also that of the directors, officers, or agents who authorized, ordered, or have done any prohibited acts, and punishes such conduct by fine or imprisonment. 15 U.S.C. Sec. 24 was enacted specifically to permit the conviction of corporate officers simply because they were responsible officers of a corporation found to be in violation of the antitrust laws, regardless of any showing of personal involvement in the conduct in question. See *United States v. Wise*, 370 U.S. 405, 82 S. Ct. 1354, 8 L.Ed.2d 590 (1962). There are no corresponding sections in the Internal Revenue Code.

⁵See, e.g., *Miranda v. Arizona*, 384 U.S. 436, 467, 86 S. Ct. 1602, 16 L.Ed.2d 694 (1966) (the privilege against self-incrimination secured by the Constitution applies to all individuals); *Johnson v. New Jersey*, 384 U.S. 719, 729, 86 S. Ct. 1772, 16 L.Ed.2d 882 (1966); *Spevack v. Klein*, 385 U.S. 511, 87 S. Ct. 625, 17 L.Ed.2d 574 (1967) ("We find no room in the privilege against self-incrimination for classifications of people so as to deny it to some and extend it to others . . . we can imply no exception"); *Garrity v. New Jersey*, 385 U.S. 493, 87 S. Ct. 616, 17 L.Ed.2d 562 (1967) (statements obtained when police officers were faced with a choice of self-incrimination or job forfeiture are inadmissible as evidence of guilt since this pressure constitutes coercion, preventing the free and rational choice of whether to waive the privilege); *Application of Gault*, —U.S.—, 87 S.Ct.1428, 1454—L. Ed. 2d—(1967) (the Fifth Amendment is "unequivocal and without exception . . . [T]he scope of the privilege is comprehensive"; the availability of the privilege does not turn upon the type of proceedings in which its protection is invoked, but upon the nature of the statement or admission and the exposure it invites).

preme Court of the United States sustaining its view that constitutional guarantees are to be construed in a realistic manner.⁶

3. In his dissenting opinion in *Wild v. Brewer*, Judge Madden believed that the question of whether a closely held corporation has the privilege against self-incrimination should be determined with reference to the test enunciated in *United States v. White*, 322 U.S. 694, 701, 64 S. Ct. 1248, 88 L. Ed. 1542 (1948):

"Whether one can fairly say under all the circumstances that a particular type of organization has a character so impersonal in the scope of its membership and activities that it cannot be said to embody or represent the truly private or personal interests of its constituents, but rather to embody their common or group interests only."

Constitutional protections have been extended to partnerships as long ago as *Boyd v. United States*, 116 U.S. 616, 6 S. Ct. 524, 29 L. Ed. 746 (1886). That the *White* test is workable as to partnerships is shown in *United States v. Cogan*, 257 F. Supp. 170 (S. D. N. Y. 1966). The *White* test should also be applied to closely held corporations; petitioners commend to the Court Judge Madden's views in this regard. Under the recent Supreme Court decisions, whether the particular entity claiming the privilege is a corporation is no longer a useful inquiry, since that question does not advance inquiry as to whether the entity is so impersonal

⁶In *Warden, Maryland Penitentiary, v. Hayden*, — U.S. —, 87 S. Ct. 1642, 1651, — L.Ed2d — (May 29, 1967), the Court abolished the distinction between "mere evidence" and "fruits of crime" for purposes of the validity of a seizure following a search without a warrant because "there is no viable reason to distinguish intrusions to secure 'mere evidence' from intrusions to secure fruits, instrumentalities, or contraband," thus rejecting a prior artificial distinction that had become unworkable in light of the expanding concept of Fourth Amendment protection. And, again this Term, in *Beecher v. Alabama*, 28 S. Ct. Bull. B. 127, 129-30 (Oct. 23, 1967), the Court held, in a case involving the admissibility of a subsequent confession given after a prior confession had been obtained as a result of illegal police activity, "the constitutional inquiry into the issue of voluntariness requires more than a 'mere color-matching of cases'"; it requires a "realistic appraisal of the circumstances" in which an accused finds himself.

that the personal privileges otherwise available to its participants have been lost.⁷

4. The direct effect upon the individual officers, shareholders, and directors should their corporate records be required to be produced cannot be overemphasized. Should such production be required, they would not obtain immunity under 15 U.S.C. Secs. 32 and 33, since these statutes only provide immunity should they themselves be required, pursuant to subpoena, to testify. And, under 15 U.S.C. Sec. 24, should the corporate records lead to the conviction of the corporation, conviction of the officers, shareholders, and directors would be possible simply upon the showing of the corporation's guilt and their position as responsible officers within it. Thus the officers, shareholders, and directors face criminal prosecution in the strict sense should the corporate records be required to be produced.⁸ In addition to criminal liability in a strict sense, should the documents be required to be produced, the officers would also suffer in a manner that would make the assertion of their privilege costly even should only their corporation be convicted as the result of the production of the documents that are sought, by (1) the financial loss to the corporation,

⁷The majority in *Wild v. Brewer* relied simply upon *Grant v. United States*, 227 U.S. 74, 33 S. Ct. 190, 57 L.Ed. 426 (1912), and *Wilson v. United States*, 21 U.S. 361, 31 S. Ct. 538, 55 L. Ed. 771 (1911). While these decisions have been followed through the years, courts have had difficulty with them in light of the more recent Supreme Court cases. See, e.g., *Hair Industry Ltd. v. United States*, 340 F.2d 510, 511 (2d Cir. 1965); *Wright v. Detwiler*, 241 F. Supp. 753 (W. D. Pa. 1964).

Given the clear expression of the Supreme Court's more recent views with respect to constitutional rights, it is apparent that it has overruled *Grant* and *Wilson* by implication. This Court, in treating petitioners' appeal from the District Court's order as a petition for a writ of mandamus, also recognized that petitioners' argument "is not wholly without merit and we are presented here with a substantial question which the appellants are entitled to have decided." (Opinion, p. 2)

⁸The Government itself has admitted that its purpose in seeking the corporate records is to seek to learn of individual violations of the anti-trust laws as a result of its inspection of them. See page 8 of transcript of hearing of January 23, 1967; page 12 of respondent's answering brief, and R. 41.

and therefore to the officers, shareholders, and directors individually by reason of the criminal fine that would be imposed upon conviction, (2) the prospect of civil treble damage liability to the corporation and to its officers, shareholders, and directors, in addition to any criminal fine, (3) the resulting reductions in salaries and dividends able to be paid from a lessened amount of profit, and (4) the personal stigma attached to the officers, shareholders, and directors as a result of the conviction of the corporation because of their close connection with it and their equal guilt in the public mind.

5. The recent decisions of the Supreme Court of the United States make it clear that the protection of the privilege against self-incrimination should be extended to the present case. Taken together, they hold that the privilege cannot be made costly; it cannot be available to some and not to others. The fortuity of possessing a particular status cannot serve to deny the protection of the privilege, as to which no exceptions have been made in the Fifth Amendment and none can be implied. Most importantly, what is required in every case is a realistic appraisal of the circumstances in which an individual finds himself to determine whether the privilege should be available to him.

6. The decisions of the United States Supreme Court in *Wilson* and *Grant* that applied a rigid, arbitrary test to define the scope of the Fifth Amendment privilege have been implicitly overruled by the large number of its recently decided cases that have expanded the scope of the privilege. Thus, *Wild v. Brewer*, to the extent that its holding was based upon those two cases, should no longer stand. In addition, the existence of statutes in the antitrust field that have no counterparts in the Internal Revenue Code provide additional reasons for holding that *Wild v. Brewer* is not controlling and that the privilege against self-incrimination should be applicable under the circumstances presented by this petition.

For these reasons, therefore, the Court should rehear the petition en banc and reverse the order previously entered in this case.

Respectfully submitted,

LEWIS ROCA BEAUCHAMP &
LINTON

By John P. Frank

John J. Flynn

Paul G. Ulrich

Attorneys for Petitioners

November, 1967

I certify that, in connection with the preparation of this petition for rehearing, in my judgment it is well founded and that it is not interposed for delay.

Paul G. Ulrich

IN THE
United States Court of Appeals
FOR THE NINTH CIRCUIT

No. 21806 ✓

STEVEN MICHAEL OSHATZ,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

APPELLANT'S OPENING BRIEF

FILED

FEB 8 1968

WM. B. LUCK, CLERK

J. B. TIETZ
410 Douglas Building
257 South Spring Street
Los Angeles, California 90012
Attorney for Appellant

FEB 8 1968

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IN THE
United States Court of Appeals
FOR THE NINTH CIRCUIT

No. 21806

STEVEN MICHAEL OSHATZ,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

APPELLANT'S OPENING BRIEF

JURISDICTION

This is an appeal from a judgment rendered by the United States District Court for the (old) Southern District of California.

The appellant was sentenced to the custody of the Attorney General for a period of three years after a one count conviction for violation of Title 50, United States Code App. Section 462 (knowingly fail and refuse to be inducted into the Armed Forces of the United States), Universal Military Training and Service Act [CT 6].¹

1. CT refers to Clerk's Transcript.

Title 18, United States Code, Section 3231, conferred jurisdiction in the District Court over the prosecution of this case. The United States Court of Appeals for the Ninth Circuit has jurisdiction of this appeal under Rule 37 (A) (1) and (2) of the Federal Rules of Criminal Procedure. Notice of Appeal was filed in the time and manner required by law [CT 7].

STATEMENT OF THE CASE

The indictment charged appellant with a violation of the Universal Military Training and Service Act for refusing to submit to induction [CT 2].

Appellant pleaded "not guilty" and was tried by the Honorable Jesse W. Curtis, District Judge, sitting alone without a jury. Appellant was found guilty and sentenced to imprisonment for a period of three years [CT 6].

A written motion for judgment of acquittal was filed during the trial [CT 4].

FACTS

The pertinent facts of this appeal are:

Appellant timely filed an SSS Form No. 150, Special Form for Conscientious Objector. [Ex.* 35-44].

In it he made out every element of a prima facie case.

[If any controversy arises on the above two statements we will deal with the matter in our Closing Brief].

*Ex. refers to the Government's Exhibit, the complete Selective Service System file of defendant.

Appellant sent several character-reference letters to the local board to support his claim. [Ex. 47-60, 62].

The local board sent him an invitation "to present yourself for an interview on February 1, 1966." [Ex. 61].

An account of this interview, made by a board employee [Ex. 64-66] shows, we will argue (1) a pre-occupation on the part of the board members with illegal bases for decision and (2) an illegal refusal to "reopen" appellant's classification.

He was ordered to report for induction on March 22, 1966. He did report but refused to submit to induction. It is demonstrable that, during the proceedings immediately prior to being called on to submit to induction he was not given the mandatory opportunity to execute DD Form 98, or refuse to do so. [Ex. 73 (a)].

QUESTIONS PRESENTED

I

Was a denial of a deferred classification to appellant, by the Selective Service System, without basis in fact, arbitrary and contrary to law? This was raised by the Motion for Judgment of Acquittal.

II

Was the appellant given a fair or a proper hearing by his local board? This question was also raised by the motion.

III

Was the appellant properly processed at the induction station by the proceedings accorded him? This question was also raised by the motion.

SPECIFICATION OF ERROR

I

The District Court erred in denying the Motion for Judgment of Acquittal.

SUMMARY OF ARGUMENT

I

Appellant made out a prima facie case as a conscientious objector. The task of the court is to search the record for some affirmative evidence to support the local board's denial of I-O classification to appellant. The record in this case is barren of any such evidence.

II

The evidence in the record shows he was not given a fair hearing by the board members, nor a proper one.

III

The un rebutted evidence in the record shows that the induction ceremony was contrary to law and prejudicial to appellant.

ARGUMENT

I

The Denial of a Conscientious Objector Classification by the Selective Service System Was Without Basis in Fact, Arbitrary, Capricious and Contrary to Law.

Section 6 (j) of Title 1 of the Universal Military Training and Service Act, as amended [50 U.S.C. App. 456 (j)], provides:

“Nothing contained in this title . . . shall be construed to require that any person be subject to combatant training and service in the armed forces of the United States who, by reason of religious training and belief, is conscientiously opposed to participation in war in any form . . .”

Section 1622.14 (A) of the Selective Service Regulations [32 C.F.R. 1622.14 (A)] provides:

“1622.14 Class I-O: Conscientious Objector Available for Civilian Work, Contributing to the Maintenance of the National Health, Safety or Interest.—(A) In Class I-O shall be placed every registrant who would have been classified in Class I-A but for the fact that he has been found, by reason of religious training and belief, to be conscientiously opposed to participation in war in any form and to be conscientiously opposed to participation in both combatant and noncombatant training and service in the armed forces.”

The local board's duties and the courts' scope of review in draft cases were spelled out by the United States Supreme Court in *Dickinson v. United States*, 74 S.Ct. 152, 157, 158, 346 U.S. 389 (1953):

"The task of the courts in cases such as this is to search the record for some affirmative evidence to support the local board's overt or implicit finding that a registrant has not painted a complete or accurate picture of his activities. . . . If the facts are disputed the board bears the ultimate responsibility for resolving the conflict—the courts will not interfere. Nor will the courts apply the test of 'substantial evidence'. However, the courts may properly insist that there be some proof that is incompatible with the registrant's proof of exemption."

"... when the uncontroverted evidence supporting the registrant's claim places him *prima facie* within the statutory exemption, dismissal of the claim solely on the basis of suspicion and speculation is both contrary to the spirit of the Act and foreign to our concepts of justice."

The dissenting opinion of Mr. Justice Jackson states the teachings even more explicitly (74 S.Ct. 152, 159):

"Under today's decision, it is not sufficient that the board disbelieve the registrant. The board must find and record affirmative evidence that he has misrepresented his case. . . ."

In the present instance appellant made out a *prima facie* case for a I-O classification when he asked for and then filed with the local board his Form 150 in which he claimed conscientious objection to war in any form based upon religious training and belief.

The government's case (the appellant's Selective Service file placed in evidence as the government's exhibit) is totally barren of any evidence whatsoever tending to cast

the slightest doubt on appellant's sincerity or truthfulness, or that he hasn't presented a correct picture.

Thus the local board's denial of I-O classification to appellant and classifying him in Class I-A was without basis in fact and upholding that arbitrary classification would be contrary to the rule of law as set forth in *Dickinson*.

II

Appellant Was Not Given a Fair Hearing, or a Proper One.

A. The hearing was unfair [Ex. 64-66].

If the local board had not decided that the hearing was to be "an interview" and thus indicating their intention to not permit their registrant to have an administrative appeal [there is no appeal from an adverse decision resulting from an interview] the following facts might not be fatal to the fairness of the hearing. As it is, a preoccupation with erroneous standards, that is, ones not set up by the act or the regulations, and ones declared erroneous by the courts, makes such a hearing a travesty.

At this interview it was initially determined that the registrant had been brought up by his parents "with Hebrew School and Temple". This is wholly sufficient for the "religious training" required by Congress. See *In re Nissen*, (D. Mass. 1956) 146 F.Supp. 361, 363. Then, this unnecessary dialog [Ex. 64] followed:

"Luppen: Were you Bar Mitzvah?

Registrant: No.

Luppen: You are not a member of the Jewish Faith at this time?

Registrant: I did not accept the Jewish Faith.

Luppen: To clarify, you are not a member of the Jewish Faith?

Registrant: No.”

The Second Circuit in *Jakobson v. United States*, 325 F.2d 409 (2 Cir., No. 28137), posed its problem:

“If we were certain that the denial of exemption rested on a finding of insincerity, Jakobson’s five year delay in claiming conscientious objection and his shift of position after making the claim would oblige us to affirm his conviction.” [412].

But it decided:

“On the other hand, if the Appeal Board, although believing Jakobson to be sincere, based its classification on the ground that his conscientious objection was not the result of religious training and belief, we would be compelled to reverse the conviction and direct dismissal of the indictment. For we rule it an erroneous construction of the statute to conclude that Jakobson’s beliefs fell outside its definition of religion.” [412].

The core problem in *Jakobson, supra*, was similar to ours: were Jakobson’s views on conscientious objection based on religious beliefs? The Second Circuit devoted much of its opinion in *Jakobson* to an analysis of the evidence in the light of the latest Supreme Court decisions defining religious belief.

The thrust of the Supreme Court’s decisions defining religion has also been analysed by legal writers, such as

law professor Francis J. Conklin, S.J., writing in the *Georgetown Law Journal* [1963, v. 51, p. 252], as follows:

"It is now evident that the line of reasoning followed by Judge Hand in *Kauten** has been adopted by the Supreme Court as the current interpretation of the meaning of the word 'religion' in the first amendment. In *Torcaso v. Watkins*¹¹² the Supreme Court, in holding that the Maryland religious test for public office which required a declaration of belief in the existence of God was an unconstitutional invasion of appellant's freedom of belief and religion, all but explicitly declared that the 'Supreme Being Clause' of the Selective Service Act is now unconstitutional. The opinion of the Court, authored by Mr. Justice Black, clearly demonstrates that the 'Supreme Being Clause' is repugnant to the first amendment since it aids 'all religions as against non-believers,' and aids some 'religions based on a belief in the existence of God as against those religions founded on different beliefs.'"¹¹³ [276].

Illegal standards relied upon by an administrative officer that become a part of the draft board file have many times been relied upon for the reversal of convictions. See *Annett v. United States*, 205 F.2d 689 (10th Cir., 1953); *Sicurella v. United States*, 348 U.S. 385 (1955); *Taffs v. United States*, 208 F.2d 329 (8th Cir., 1953).

Our point, that a situation like this requires reversal of a conviction, was stated by this Court in *Affeldt v. United States*, 9 Cir., 1954, 218 F.2d 112 at 115.

**Kauten v. Downer*, (U.S. ex rel.) 2 Cir., 1943, 133 F.2d 733.

In addition to *Affeldt, supra*, this Court has condemned a determination where it appeared that "the appeal board may have accepted the erroneous advice of the Department of Justice * * *". See *United States v. Batelaan*, 9 Cir., 1954, 217 F.2d 946, last paragraph. Other courts have followed this salutary principle in criminal cases, and one not citing *Batelaan* or *Affeldt* is *United States v. Erikson*, S.D. N.Y. 1957, 149 F.Supp. 576. Cf. *MacMurray v. United States*, 9 Cir., 230 F.2d 928.

This sub-point (of "imported" standards) will not be belabored for the next, we submit is determinative.

B. The hearing was not a proper one.

It should have been held as an "Appearance Before Local Board." This would have given the registrant the right to ask for an administrative appeal. Such a method of handling this problem he presented was wrong and this Court has so declared. The latest appellate decision on this subject is *Miller v. United States*, 9 Cir., December 29, 1967, F.2d

III

The Induction Ceremony Point

Appellant was not properly processed on the "loyalty" portion of the induction proceedings.

The facts are *demonstrated* by the government's own evidence [Ex. 73 (a)]. It states that appellant "was not given DD Form 98 to initiate."

The pertinent part of the Selective Service System Regulation (32 C.F.R.) provides:

"1632.16 INDUCTION:—At the induction station the selected men who have been forwarded for induction *and found qualified* will be inducted into the Armed Forces." (Emphasis supplied).

Since there are no System regulations on induction proceedings the Army regulations govern. *Chernekov v. United States*, 9 Cir., 1955, 219 F.2d 721, 724, n. 12.

The pertinent Army regulation is:

AR 601-270 "Personnel Procurement, Armed Forces Examining and Entrance Stations", provides in its pertinent part:

"80. DD Form 98 (Armed Forces Security Questionnaire). A. Preparation: At the completion of the pre-induction examinations all registrants, except registrants in Class I-O (conscientious objectors), who are found to be militarily qualified for service in the Armed Forces, including administrative acceptees, will be given the opportunity to accomplish the Armed Forces Security Questionnaire. DD Form 98 will not be accomplished by registrants otherwise disqualified for induction, and processing under AR 604-10 will not be undertaken for registrants who are otherwise disqualified for induction.

- (1) A commissioned officer who is thoroughly conversant with the regulations and policies pertaining to the accomplishment of the Armed Forces Security Questionnaire (DD Form 98) will be designated to have direct control over the procedures and will present the orientation established for completing the form.
- (2) Volunteers for immediate induction and previously qualified registrants being processed for induction, who have not accomplished the security

questionnaire, or whose security questionnaire is invalid, will be given the opportunity to accomplish the security questionnaire prior to induction.

- (3) At the time registrants are given the opportunity to accomplish the security questionnaire, an orientation will be presented in a manner so as to insure all persons understand the importance of accomplishing the questionnaire. The orientation will consist of the informational material outlined in Appendix IV.
- (4) Individuals who are about to accomplish DD Form 98 will be fully instructed as to the importance of the entries to be made in section IV and of affixing their signatures, and the reasons their cooperation in the accomplishment of the Armed Forces Security Questionnaire is an important step at the beginning of their military service.
- (5) Each individual will be instructed and prepared to respond in accordance with his rights and understanding of the entries he is required to make. Coercion or persuasion will not be used.
- (6) Following the orientation, each individual will be directed to carefully read the entire contents of the DD Form 98 and to answer all questions in section IV by writing 'Yes' or 'No' in the appropriate columns. All entries on the DD Form 98 will be in the individual's own handwriting except where use of typed entries is specified.
- (7) Immediately following the completion of the DD Form 98, and affixing the signature by the declarant, a commissioned officer serving as the witnessing officer will affix his own signature. The practice of permitting DD Forms 98 to accumulate for later signature will be avoided. The witnessing officer may be any duly commissioned officer. It is not mandatory, however, it is preferable that

he be an officer who is on duty with the induction station. Registrants will not be required to sign blank DD Forms 98 to be filled in at a later date by station personnel. This practice negates the value of DD Form 98 should the veracity of the statements therein be challenged. It also renders ineffective the penalty clause for falsification of the form.

- (8) Security questionnaires are valid for a period of 120 days. If the time element between preinduction and induction is in excess of 120 days, the following statement will be placed in the Remarks Section of DD Form 98:

I have this date, reviewed the contents of DD Form 98 prepared by myself on and certify that the statements then made by me are at this time full, true, and correct.

.....
Signature of
witnessing officer

.....
Signature

The use of a rubber stamp and red ink is recommended for this requirement. An orientation in accordance with (3) above will be required for these individuals. An examinee who qualifies or refuses to accomplish this statement will be processed as for initial examinees of these categories.

b. Disposition.

- (1) Security questionnaires which are satisfactorily accomplished by registrants will be forwarded to the appropriate Selective Service local board other records which pertain to the individual, or, when applicable, to the military installation of initial reception.

- (2) **A registrant who qualifies or refuses to accomplish the DD Form 98 in its entirety (see AR 604-10) or who discloses significant derogatory information with respect to his background, or invokes constitutional privileges, and registrants admitting current membership in the Communist party ('known Communists') and registrants for whom credible derogatory information has been received from a reliable source indicating Communist party membership ('alleged Communists') as defined in AR 604-10, will not be inducted into the Armed Forces pending completion of a thorough investigation (Bold type supplied).**
- (3) Investigative action as prescribed in AR 604-10 will be initiated at the induction station in all cases of registrants referred to in (2) above.
- (4) If a registrant refuses to complete part of a DD Form 98 he will be requested to enter an explanation of the refusal in the remarks section and to sign the form. A commissioned officer serving as the witnessing officer will affix his own signature. If a registrant refuses to complete any part of a DD Form 98 and refuses to enter an explanation of the refusal in the remarks section and sign the form, the following statement will be entered in the remarks section of the form:

(Registrant's name), a registrant, under the Universal Military Training and Service Act, was this date given an opportunity to execute DD Form 98 and in my presence he refused to do so.

This statement will be signed by a commissioned officer, and forwarded to the appropriate investigative agency in accordance with (3) above.

- (5) DD Form 62 prepared for registrants referred to in (2) above will contain in remarks section the notation 'Acceptability for induction held in abey-

ance, not presently acceptable for induction.' No other notations will be made on the DD Form 62 and no other information or papers will be released to Selective Service local boards. Entries in regard to acceptability for induction will not be made.

- (6) Item 22 on DD Form 47 pertaining to registrants referred to in (2) above will not be completed until the result of investigative action is received from higher headquarters.
- (7) Entry on SSS Form 225 (Physical Examination List) for registrants for whom investigative action has been initiated in accordance with (3) above will indicate induction being held in abeyance. Same notation as required in (5) above will be entered.
- (8) At the time final determination of the case under investigation has been made, the induction station concerned will be advised as to the appropriate action to be taken regarding the registrant whose induction is being held in abeyance. Upon receipt of information from higher headquarters indicating that registrants whose induction is being held in abeyance have been cleared for induction, the induction station will prepare a new DD Form 62 in its entirety and forward it to the appropriate Selective Service local board. Upon receipt of information from higher headquarters indicating that registrants whose acceptability is being held in abeyance have been determined to be unacceptable for induction, the induction station will prepare a new DD Form 62 and forward it to the appropriate Selective Service local board. Original and copy of DD Form 62 prepared in accordance with (5) above, when retained, will be destroyed when the forms are accomplished."

The induction officials did not give this appellant the opportunity to qualify nor did they take any of the appropriate steps prescribed by the Army Regulation. Instead, they ordered him to submit to induction in violation of their own regulations in that they had not taken the required steps to determine if he was qualified for induction.

Note that the regulation is stated in mandatory language. See especially section B (2) set forth above. That section states that registrants in the position appellant was in on March 22, 1966, "will not be inducted".

In a District Court case, the Honorable William C. Mathes had before him a defendant in the same posture as this appellant (*United States v. Israel Feuer*, 25778-WM, S.D. Calif.). In acquitting that defendant, the Judge said:

"This is almost like—ethically at least—a registrant with his record who has vision that just doesn't quite meet the Army requirements, and the doctor says, 'Well, we will pass him anyway because he will refuse to be inducted and they will send him to prison for committing a felony.' There is too much that is incongruous about that. It is too much like the Communists themselves would do, if you please, in the language of the street, to set a man up to convict him of a felony." (Reporter's Transcript in #25778-WM, page 3, lines 19 through 25).

In response to the government's argument that the irregularity had not damaged that defendant, Judge Mathes said:

"Well, it is akin to unlawful entrapment. Morally it is akin to unlawful entrapment as I view it. You are

going to force a man into a position where you know he is going to commit a felony; whereas if you let him go the other way, he wouldn't." (Reporter's Transcript in #25778-WM, page 4, lines 10 to 16).

A defendant in a draft refusal case ordinarily is required to show that he has exhausted all of his administrative remedies or he may not mount an attack on his classification as a defense in court. It is said he is required to exhaust his administrative remedies so that the courts will not be burdened with trials that might have been avoided by the defendant's success at some stage of the administrative process which would preclude his being ordered to submit to induction. The courts have often been rather rigid on this exhaustion point, requiring that the defendant go to the brink of induction, that he complete every step of the process prior to refusing to actually enter the military.

All of the arguments that support the requirement that the defendant exhaust the administrative process apply with equal vigor to the government. Shortcuts to induction taken by the government burden the courts with cases that could have been avoided altogether, to say nothing about the inconvenience and expense to the young men involved.

For this reason, as well as for the reason that deprivation of a chance to avoid the dilemma is grossly unfair to the appellant, the government should be required to exhaust the administrative opportunities for rejection that the regulations provide before forcing the registrant to induction, refusal and trial.

CONCLUSION

For the reasons above stated, the judgment of the district court should be reversed and an order entered directing the district court to render and enter a judgment of acquittal.

Respectfully submitted,

J. B. TIETZ
Attorney for Appellant

February 9, 1968.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

J. B. TIETZ
Attorney for Appellant

N O. 2 1 8 0 6
IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

STEVEN MICHAEL OSHATZ,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF

APPEAL FROM
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CENTRAL DIVISION

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United States Attorney,
ROBERT L. BROSIQ,
Assistant U. S. Attorney,
Chief, Criminal Division.
RONALD S. MORROW,
Assistant U. S. Attorney,

1200 U. S. Court House
312 North Spring Street
Los Angeles, California 90012

Attorneys for Appellee,
United States of America

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Chief, Criminal Division.
RONALD S. MORROW,
Assistant U. S. Attorney,

1200 U. S. Court House
312 North Spring Street
Los Angeles, California 90012

Attorneys for Appellee,
United States of America

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IN THE UNITED STATES COURT OF APPEALS
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APPELLEE'S BRIEF

I

STATEMENT OF JURISDICTION

On November 23, 1966, the appellant was indicted in one count, by the Federal Grand Jury for the Southern District of California, Central Division, for a refusal to be inducted into the Armed Services, in violation of Title 50, United States Code App., Section 462 [C. T. 2]. ^{1/} Following a court trial before the Honorable Jesse W. Curtis, United States District Judge, on January 9, 1967, the defendant was found guilty, and on February 20, 1967, appellant was committed to the custody of the Attorney General for three

years [C. T. 6].

Appellant filed, on February 28, 1967, a timely notice of appeal [C. T. 7].

The District Court had jurisdiction under the provisions of Title 50, United States Code App. , Section 462, and Title 18, United States Code, Section 3231.

This Court has jurisdiction to review the judgment pursuant to Title 28, United States Code, Sections 1291 and 1294.

II

APPLICABLE STATUTE

Title 50, United States Code App. , Section 462 provides in pertinent part:

"Any member of the Selective Service System or any other person charged as herein provided with the duty of carrying out any of the provisions of this title . . . or the rules or regulations made or directions given thereunder, who shall knowingly fail or neglect to perform such duty . . . or who otherwise evades or refuses . . . service in the armed forces or any of the requirements of this title . . . or who in any manner shall knowingly fail or neglect or refuse to perform any duty required of him under or in the execution of this title . . . or rules, regulations or directions made pursuant to this title . . . shall,

upon conviction in any District Court of the United States of competent jurisdiction, be punished by imprisonment for not more than five years or a fine of not more than \$10,000, or by both. . ."

III

QUESTIONS PRESENTED

A. Whether appellant was properly processed by the Local Board of the Selective Service System.

B. Whether the appellant may raise on appeal a point not raised in the District Court.

C. Assuming appellant can raise on appeal an issue not raised in the trial court, whether he suffered any prejudice by not having had an opportunity to execute a Security Questionnaire.

IV

STATEMENT OF FACTS

Unless otherwise indicated, page references in the Statement of Facts are references to the Selective Service File of appellant, Exhibit One, in evidence.

Appellant registered with Local Board No. 100 on November 4, 1958 (pp. 1, 2).

On October 5, 1959, the Board received from appellant

a completed Classification Questionnaire (Form SSS No. 100) wherein the appellant did not sign the section relating to conscientious objection (p. 6). On September 6, 1961 The Board received from appellant a Form No. 127, Current Information Questionnaire, wherein he in no way noted that he claimed the status or was a conscientious objector (pp. 15-16).

On October 2, 1961, appellant was classified in Class I-A, and was mailed a notice of such classification on Form No. 110 on October 3, 1961 (pp. 3, 11).

On May 22, 1963, The Board received a Current Information Questionnaire from appellant indicating he sold "Hot Dogs and Coke" and in no way indicated he claimed the status of conscientious objector (pp. 18-19).

On June 5, 1963, the appellant reported for an Armed Forces Physical Examination (pp. 17, 21) and was found acceptable (DD Form 62) (p. 20). On July 26, 1963, the Form D.D. 62 was mailed to appellant (p. 11).

On June 14, 1965, The Board received another Current Information Questionnaire from appellant in which he stated he was a self-employed artist and also gave no indication that he claimed the status of conscientious objector (pp. 28-29).

On November 2, 1965, appellant was classified in Class I-A by The Board, and notice thereof was sent to appellant on Form No. 110 on November 8, 1965 (p. 11). No appeal was taken from the above classification (p. 11).

On November 19, 1965, The Board sent appellant an Order



to Report for Induction (SSS Form No. 252) on December 28, 1965 (pp. 11, 30).

On December 1, 1965, The Board received a letter from appellant stating he wished re-classification from I-A to I-O (Conscientious Objector). Appellant also asked for a cancellation of his induction order and for transfer of his local board to New York City (p. 31). On December 9, 1965, The Board sent a notice to appellant that his induction had been postponed, and enclosed therewith was a Form 150 (pp. 11, 33-34). On December 20, 1965, The Board received a completed Form 150 (Special Form for Conscientious Objectors) from appellant (pp. 35-45).

On February 1, 1966, appellant had an interview before The Board, at which time, among other things, he stated that he was not a member of a religious organization although he believed in a Supreme Being; that he did not accept the faith of his parents; that he belonged to no organization, and that he would not accept non-combatant service, but would accept civilian work in lieu of induction. At the conclusion of the interview The Board decided to not reopen the classification of appellant (pp. 11, 64-66). On February 7, 1966, a Form C-140, was sent to appellant by which he was notified that The Board was of the opinion that the facts did not warrant the reopening of his case (p. 68).

On March 1, 1966, The Board sent appellant notice of a new date to report for induction of March 22, 1966 (p. 70). On March 22, 1966, the appellant reported to the Armed Forces Entrance Station and refused to be inducted into the Armed Forces

of the United States (pp. 73-86). After being advised of the criminal penalties involved, he was again advised to submit to induction, and again refused.

Appellant, at the time of his refusal to be inducted was not given a DD Form 98, Security Questionnaire, to execute (p. 73(a)).

V.

A. APPELLANT WAS PROPERLY PROCESSED BY THE LOCAL BOARD.

After appellant received his order to report for induction was the first time that he indicated he wanted to be classified as a conscientious objector. Appellant, in his opening brief ignores this point and its implications. Appellant argues that a prima facie showing was made and, therefore, without the board making a finding upon which a conscientious objector classification could be denied, the board's action was arbitrary, capricious, contrary to law and without a basis in fact.

Appellant's argument ignores the law. Title 32, Code of Federal Regulations, Section 1625.2, controls the board's actions, and, in pertinent part provides:

"The local board may reopen and consider anew the classification of a registrant . . . upon the written request of the registrant . . . if such request is accompanied by written information presenting facts

not considered when a registrant was classified which, if true, would justify a change in the registrant's classification; . . . provided the classification . . . of a registrant shall not be reopened after the local board has mailed to such registrant an order to report for induction . . . unless the local board first specifically finds that there has been a change in the registrant's status resulting from circumstances over which the registrant had no control. "

What the Local Board did in its interview of the appellant was to see whether any "change" resulted from 'circumstances over which the registrant had no control. "

Page 34 of the Selective Service File shows that the postponement was for the purpose of investigation. If the board were to reopen the classification then the specific finding called for by Section 1625.2 would have to have been made. A light perusal of the Form 150 submitted (p. 35), and the letters submitted (pp. 47-60), and the interview conducted (p. 64), all show that there was nothing new in appellant's thinking.

The Reporter's Transcript, at page 21, shows that appellant's opposition to war "was of long standing. "

Appellant claims that he was deprived of the rights of a hearing, reclassification, appeal, etc. A casual knowledge of the Regulations makes it apparent that such things were not available. As this Court said in Dugdale v. United States,

Slip Opinion, p. 3, (9th Cir. February 15, 1968):

" . . . He was required to show a 'change of status' occurring after receipt of the induction notice. He did not do so." (Footnote omitted.) See Boyd v. United States, 269 F.2d 607, 609-10 (9th Cir. 1955).

Once the board could not make the specific finding required, it was obligated to do one thing, and that was to send the letter appearing at page 68 of the file, and required by 32, C.F.R., §1625.4.

B. APPELLANT CANNOT RAISE ON APPEAL
A POINT NOT URGED IN THE TRIAL
COURT

Appellant cannot raise on appeal a point not raised in the trial court. Osborne v. United States, 371 F.2d 913 (9th Cir. 1967), cert. den. 387 U.S. 946; Bouchard v. United States, 344 F.2d 872 (9th Cir. 1965).

There is no reference, shown by appellant as to where he raised, in the trial court, a question as to the appellant's not having been given an opportunity to execute a DD Form 98. If the matter had been raised then the District Court could have considered it and the Government could have introduced testimony with respect thereto. It is this basic unfairness which caused the above-stated rule to have been promulgated in the first place.

Appellant may argue that in his motion for judgment of acquittal filed two days after the trial (C. T. 4), that he raised the instant point. A reading of appellant's motion reveals that it is nothing more than a shotgun blast including everything from failure to "prove a violation of the Act and Regulations" to "the President is acting beyond his powers in using draftees for the Vietnam war. "

It is noted that at page 73 of the Selective Service File, there is stated, "Mr. Steven Michael Oshatz, was determined fully qualified for induction in all respects. "

C. ASSUMING THE QUESTIONNAIRE POINT
 MAY BE RAISED ON APPEAL, APPELLANT
 SUFFERED NO PREJUDICE THEREBY AND
 IT WAS HARMLESS ERROR.

It is the law of this Circuit that mere technical deficiencies in the entire process will not work to upset a conviction. In Yaich v. United States, 283 F.2d 613, 620 (9th Cir. 1960), this Court held as follows:

" . . . Failure to comply with Selective Service Regulations which do not prejudice a registrant are not grounds for upsetting conviction based on disobedience of induction or civilian work. Uffelman v. United States, 9th Cir. , 1956, 230 F.2d 297; Kaline v. United States, 9th Cir. 1956, 235 F.2d 54. "

As of this time, appellant has claimed no prejudice and it is submitted none exists to appellant by virtue of his not having been given an opportunity to execute a Security Questionnaire. The regulation of the Army requiring its execution is only for the protection of the Army and not for that of the registrant.

Appellant cites a case, Chernekoff v. United States, 219 F.2d 721 (9th Cir. 1955), for the proposition that Army regulations are to be followed when there are no applicable Selective Service Regulations. Chernekoff, does not, however, hold or imply that mere failure to follow said regulations requires reversal. In Chernekoff the registrant was not asked to take the legendary "one step forward." The Court reasoned that said requirement was for the purpose of giving the registrant one last chance to reconsider his already stated intent to refuse induction. In the instant case the Security Questionnaire requirement is not for the protection of the registrant, but for that of the United States. While the "one step forward" and the physical examination are for the benefit of the registrant, it is inconceivable that the DD Form 98 is likewise. It is interesting to note that at the present time the applicable Army regulation has been changed.

Aside from the fact that appellant has not been prejudiced, he has not even claimed that he would have been ineligible for induction if he had executed the form. Nowhere does he claim that he was or is, a member of the Communist Party or any of the other organizations listed in the subject form.

Yaich, supra, refers to the Selective Service Regulations,

but there is no reason why the holding thereof should not apply to the Army regulations as well. The observation is made that Oshatz did not refuse induction because of the DD Form 98 but because of his professed conscientious objection to war.

VI

CONCLUSION

For the above-stated reasons the judgment of the District Court should be affirmed.

Respectfully submitted,

WM. MATTHEW BYRNE, JR.,
United States Attorney,

ROBERT L. BROSIO,
Assistant U. S. Attorney,
Chief, Criminal Division,

RONALD S. MORROW,
Assistant U. S. Attorney,

Attorneys for Appellee,
United States of America

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Ronald S. Morrow

RONALD S. MORROW

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United States Court of Appeals
FOR THE NINTH CIRCUIT

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UNITED STATES OF AMERICA,
Appellee.

APPELLANT'S CLOSING BRIEF

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WM. B. LUCK, CLERK

J. B. TIETZ
410 Douglas Building
257 South Spring Street
Los Angeles, California 90012
Attorney for Appellant

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APPELLANT'S CLOSING BRIEF

We will consider the Argument of Appellee, which starts on page 6 of its brief:

A. The Administrative Processing Point

1. Appellee states that "Appellant, in his Opening Brief ignores this point and its implications [that Appellant filed his conscientious objection claim for the first time after the order to report for induction]."

This "point and its implications" arise only if they are asserted by the appellee as a bar to a consideration of the

merits of appellant's claim. The appellee has now chosen to raise this bar and to avoid a head-on clash with our no-basis-in-fact point.

Our reply to Appellee is: it has been held, and is good law, that a registrant may raise such a claim for the first time after an order to report for induction and that an arbitrary refusal to reopen the classification, a true "re-opening", one that gives the registrant an administrative appellate opportunity, is to be labelled "arbitrary" by the courts.

Gearey v. United States, 2 Cir., 1966, 368 F. 2d 144;
Miller v. United States, 9 Cir., 1967, 388 F. 2d 973;
Hamilton v. Commanding Officer, 9 Cir., 1964, 328 F. 2d 799;
MacMurray v. United States, 9 Cir., 1964, 230 F. 2d 928;
U. S. v. Sobczak, N.D. Ga., 1966, 264 F. Supp. 752.

There have been many district courts that have followed this rationale, namely, that a non-frivolous claim of conscientious objection, made late, should have the standard administrative opportunities.

U. S. v. Longworth, S.D. Ohio, 1967, 269 F. Supp. 971, 973.

One of the latest, and one on the extreme of the spectrum (that is, a claim first made after the refusal to submit to induction), is *U. S. A. v. Federspiel, Jr.*, N.D. Ohio, No. CR 67-240. We have an 18 page Transcript of Oral Opinion of the Honorable Thomas D. Lambros, Judge of said Court, on Monday, February 19, 1968, at 2:00 o'clock P.M. Three excerpts give the facts and the reasoning:

"The draft board thereafter, on November 4, 1965, had a board meeting; and as a result of the board meeting, the following communication was sent by the clerk of the draft board to the State Director, which reads as follows and that is Item 65 in the Selective Service file:

Dear Sir:

At the local board meeting held on 4 November, 1965, the board members reviewed the file of the above named registrant. SSS Form No. 150, Special Form for Conscientious Objectors was reviewed by the local board, and the registrant's classification was not reopened. The local board did not consider this a bona fide conscientious objection claim. The board members also noted that the registrant did not request SSS Form No. 150 until after he had refused to submit to induction.

By Direction of the Local Board, Norma L. Nead, Clerk." [p. 5]

- B. "This could all have been avoided if the draft board in this case had done its job and not passed a snap judgment; had they been advised under the circumstances a prima facie case was made out in this case and afforded him a hearing.

There is a right way to do things and a wrong way to do them. In this case, the draft board did it wrong." [p. 16]

- C. "A draft board should be advised in these cases, that notwithstanding the fact that they are very impatient with conscientious objector claims, and notwithstanding the fact that there are thousands of conscientious objector claims throughout this country,

nonetheless, because of the unique ingredients and components of such a claim, which involves a state-of-mind attitude of individuals, a judgment should not be passed merely by reviewing a Form 150. There should be a confrontation review and analysis—a time-consuming process. That is part of the job.

In this case, the draft board did not do its job. It took the short route, the short cut; it did not comply with the regulations.

The Court finds that the Defendant was thus technically denied due process. The Court finds that the failure to reopen and reconsider this case was improper.” [pp. 17-18]

The question concerning the time of “final crystallization” of appellant’s claim is one to be determined by the record. The entries in the government’s exhibit concerning his Appearance Before Local Board (the board’s version, pages 64-66) and his testimony, reporter’s transcript, page 23, shows, we contend, that it was after the order to report for induction. This, giving weight to *Gearey* and the other cases cited above, would require the reopening with the attendant administrative appellate opportunity.

2. Appellee next argues (p. 7) “What the local board did in its interview of the appellant, was to see whether any ‘change’ resulted from ‘circumstances over which the registrant had no control.’”

We say: what the local board did was to justify its refusal. Our Opening Brief argues this. See what one writer (not this one) said in 54 *California Law Review* 2123 (1966) at 2165:

“Fourth, the informality which surrounds local board proceedings is supposed to give a registrant the opportunity for a full and frank discussion of his claim for deferment or exemption with board members. But some board members have a wholly different concept of the function of the personal appearance. They view it more as an opportunity for them to justify their denial of an exemption or deferment to a registrant than as an opportunity for the registrant to convince the board he deserves a deferment or exemption. Because these board members do not attend the personal appearance for the purpose of listening to the registrant’s story and perhaps being persuaded by it, they very seldom change a classification as a result of the registrant’s appearance.”

B. “New” Appellate Points

Appellee seeks to bar this point from consideration on appeal on the declared basis, “Appellant cannot raise on appeal a point not raised in the trial court” [p. 9].

1. The Motion for Judgment of Acquittal [TR 4-5] reads:

“4. One purpose of this regulation is self-evident. It is intended to give a registrant a last clear chance to change his mind and accept induction rather than certain indictment and possible conviction for a felony carrying a maximum punishment of five years or a fine of not more than \$10,000.00 or both. The regulation is couched in mandatory, not discretionary, language.”

Appellee points to the fact that the Motion was filed two days after the trial. We comment:

(a) The Reporter's Transcript reads:

"MR. TIETZ: If the court please, this morning when I was in court I had a typewritten motion for judgment of acquittal, six copies, and I went back to the office and took the papers out of my file for various discussions and I do not find my motion for judgment of acquittal which I have always in every case filed.

THE COURT: Well, it may be deemed to have been filed. You can supply a copy of it later.

MR. TIETZ: Thank you." [p. 9]

(b) The ground of the motion that is in question (No. 4, in this case) is identical to that in other cases *before this trial judge*, and known to this Court. See *Dugdale v. U. S.*, 9 Cir., No. 21789, RT 22 (No. 4); *Edwards v. U. S.*, 9 Cir., No. 21879, RT 22 (No. 10).

2. Additionally, this Court has not been loath to consider, and rule on, patent error:

Chernekoff v. U. S., 9 Cir., 1955, 219 F. 2d 721.

It was said in argument that this omission is in consonance with the practice in Los Angeles County. If that be so, we have serious doubt as to the validity of such a practice by the local boards. Suffice it here to observe that this deviation from the regulation was not affected by the action of the appeal board. *Franks v. United States*, 9 Cir., 1954, 216 F. 2d 266. [724]

Likewise in the course of argument it was represented and unchallenged that the derogatory information in the file as to appellant's religious sincerity concerns

a single conviction for drunkenness and a later one for speeding. To be a good church member does not necessarily entail being a saint. A mortal may occasionally weaken and still remain loyal to the tenets of his faith. A conscientious objector is not to be considered an outcast susceptible of being convicted of a felony by any stray scintilla of evidence indicating sporadic deviation from the principles and approved practices of his religion. We are all children of Eve. [724]

Reversal is also required because the appellant never refused to be inducted into the Armed Forces in the manner required by the law in order to warrant prosecution. [724]

C. "There Was No Prejudice to Appellant"

Appellee argues that there was no prejudice to appellant. [p. 9] In our Opening Brief we quoted the opinion of Judge Wm. Mathes, in *U. S. v. Feuer*, No. 25778, S.D. Calif., that it is akin to entrapment.

We argue that he was deprived of a procedural opportunity to be disqualified comparable to that of a physical examination or the "warning" of penalty for refusal, or the "second chance" to refuse. The odds of rejection may be slim but he was entitled to the rejection opportunity.

We argue this deprivation approaches the loss suffered by one who is short circuited from the opportunities of a hearing and of an administrative appeal. A final argument: a hearing given, but unfairly conducted has been roundly scored by the Supreme Court:

"Petitioner has been deprived of the fair hearing required by the Act, a fundamental safeguard, and he need not specify the precise manner in which he would have used this right—and how such use would have aided his cause—in order to complain of the deprivation."

Simmons v. U. S. A., (1955) 75 S.Ct. 397, 402.

CONCLUSION

For the reasons above stated, the judgment of the district court should be reversed and an order entered directing the district court to render and enter a judgment of acquittal.

Respectfully submitted,

J. B. TIETZ

Attorney for Appellant

May 17, 1968.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

J. B. TIETZ

Attorney for Appellant

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

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WESTERN GROWTH CORPORATION,

Bankrupt.

STEPHEN CRANE, III,

Applicant and Appellant,

vs.

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Respondent.

CURTIS B. DANNING, etc. ,

Cross-Applicant,

vs.

LOUIS BENVENISTE, et al. ,

Cross-Respondents and Appellants.

FILED

OCT 3 1967

WM. B. LUCK, CLERK

OPENING BRIEF OF APPELLANTS

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

GREENBERG & GLUSKER and
RICHARD H. FLOUM
9601 Wilshire Boulevard
Suite 544
Beverly Hills, California 90210

Attorneys for Appellants

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Attorneys for Appellants

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OPENING BRIEF OF APPELLANTS

I

INTRODUCTION

Appellants are, or derive their interest from, 15 of a total of 31 persons who in the Summer of 1959 lent \$210,000 to James A. Bower and his wife. This loan was evidenced by the Bower's

execution and delivery of a promissory note in that amount and secured by a deed of trust on approximately 14-1/2 acres of real property in Escondido, California (known in these proceedings and hereafter referred to as Escondido No. 3). The Bowers were able to purchase Escondido No. 3 with part of the loan proceeds derived from the aforementioned loan.

In 1960, the other 16 of the original 31 investors assigned their undivided interests in said promissory note and deed of trust to Western Growth Corporation, the bankrupt herein, which, in the meantime, had acquired Escondido No. 3 from the Bowers, and assumed their obligation under the subject note and deed of trust.

The sole, real question presented in the two applications heard by Referee Champlin below was simply whether or not upon the sale of Escondido No. 3 appellants were entitled to be paid all of the net proceeds derived therefrom, up to the sum of \$84,452.36 plus interest thereon (the amount admittedly owed to them) or whether the Trustee in Bankruptcy was entitled to dilute their interest by asserting the claims of the 16 of the original 31 investors who, as indicated above, had previously assigned their interest in the subject note and deed of trust to the bankrupt.

But Referee Champlin erroneously focused his attention upon the red herring question of whether or not a valid security in Escondido No. 3 was created by reason of the mechanics used in effectuating the original loan.

Because appellants believed that the Referee had clearly erred in this matter, by holding (1) that the deed of trust which

came out of the original loan transaction was null and void, and (2) that appellants are only entitled to share in 33/70 of the net proceeds to be derived from the sale of Escondido No. 3, they timely petitioned the United States District Court, Central District of California to review said order. And upon entry of an order by the Honorable Thurmond Clarke, Judge of said court, summarily affirming said Referee's order without opinion, appellants perfected the subject appeal.

II

BASIS OF JURISDICTION

The appeal at bar is from an order of the Honorable Thurmond Clarke entered on February 10, 1967, affirming the order of Referee Herschel Champlin of February 1, 1966, entered upon the application of Stephen Crane, III, and the cross-application of Curtis B. Danning, Trustee in Bankruptcy for the bankrupt corporation. The District Court had jurisdiction to review said order under and pursuant to 11 U.S.C. §§ 11(7) and 46, and 28 U.S.C. §1334. This Court has jurisdiction to review said district court's order pursuant to and under 11 U.S.C. §47(a).

III

STATEMENT OF THE CASE

As will appear more fully below, most of the relevant facts

in this case were either stipulated to or are not in dispute. They are as follows:

A. Facts Concerning Validity of
Subject Note and Deed of Trust.

In the Summer of 1959, Alan Realty Company, a firm of real estate and loan brokers (Reporter's Transcript [hereafter R. T.] pp. 108, 187, 190, 193, 203) solicited and obtained from 31 of its clients a loan totaling \$210,000 on behalf of James A. and Melba L. Bower (R. T. pp. 225-26, 238-40, 244). As was normal in these transactions, the principals of Alan Realty Company expressly represented to the 31 investors that their investment would be evidenced by a promissory note from the borrower and secured by a deed of trust on real property, which representation was a major inducement to the lenders to make their loan (R. T. pp. 225-26, 261, 238-40, 246-48, 250, 269).

The \$210,000 loan proceeds were deposited by Alan Realty Company, on behalf of its 31 investor clients, into a loan escrow at the Wilshire Escrow Company (Escrow 34757) along with written escrow instruction dated August 31, 1959 executed by each of the 31 lenders (R. T. p. 29, Crane Ex. 4), providing as follows: "I hand you herewith the sum of [the applicable dollar figure] which you are authorized to deposit in this escrow and use upon the instructions of Milton N. White, Trustee." (Pretrial Conference Order, par. 7, Clerk's Transcript [hereafter C. T.] p. 95e).

Mr. White at that time was and now is an attorney duly licensed to practice law in the State of California (R. T. p. 65). At the time of the subject loan transaction, he was the attorney for Alan Realty Company and certain of its principals and had acted as such for a period of some years past (R. T. pp. 52-60, 78).

Mr. White permitted his name to be used in the loan escrow as lender and, as appears below, as beneficiary of the note and trust deed which emanate therefrom, upon the specific instructions of his client, Alan Realty Company (R. T. pp. 64-66). Indeed, he had acted as "Trustee" for Alan Realty Company before in similar loan transactions (R. T. pp. 74, 205).

Pursuant to the written instructions of each of the 31 lenders quoted above, Mr. White and the Bowers executed a 2-page loan escrow agreement also dated August 31, 1959, which is in evidence as Crane Ex. 6. These escrow instructions were signed by Mr. White as "Milton N. White, Trustee", and require Wilshire Escrow Company, as escrow, to use the \$210,000 deposited in accordance with the instructions, if on or before a certain date it held a policy of title insurance on the Escondido No. 3 property, showing title vested in James A. Bower, a married man, free of encumbrances, except:

"

"Trust deed . . . to secure note for \$210,000 dated August 31, 1959 . . . payable monthly, in favor of Milton N. White, Trustee,"

Said instructions also requested said escrow to record "any instruments delivered through this escrow, if necessary or proper in the issuance of the policy of title insurance called for" (See General Instruction 6).

The promissory note dated August 31, 1959, executed and delivered by the Bowers to Wilshire Escrow Company (in evidence as Crane Ex. 1), is made payable to "Milton N. White, Trustee" and specifically states that it is secured by a deed of trust to Wilshire Escrow Company, a corporation.

The subject deed of trust, also dated August 31, 1959 (in evidence as Crane Ex. 2), is in favor of Wilshire Escrow Company, as Trustee, and "Milton N. White, Trustee", as Beneficiary, and was admittedly executed and delivered by the Bowers to the Wilshire Escrow Company (Pretrial Conference Order, pars. 3 and 4, C. T. p. 95d). The upper left-hand portion thereof, under the printed words "When recorded mail to", bears the typewritten or stamped words: "Alan Realty Company", followed by the address thereof. This deed of trust was recorded on September 8, 1959, in the Official Records of San Diego County, and thereafter, pursuant to the express direction contained therein, was mailed to Alan Realty Company (R. T. pp. 26-27).

Mr. White testified, without contradiction, that he permitted his name to be used as trustee in the subject escrow and on the subject promissory note and deed of trust solely and simply in order to act on behalf of the original 31 investors as a dry or passive trustee (R. T. pp. 217, 197, 200, 208-210). This was

done, he testified, in order to facilitate and simplify the loan transaction by using one person in behalf of and in the place of the 31 investors, which person would act on their behalf as record beneficiary under the note and trust deed until Escondido No. 3 was subdivided into individual lots. At this time, Mr. White testified, it was contemplated that individual notes secured by individual deeds of trust on said lots would be issued and be substituted for the omnibus \$210,000 promissory note and deed of trust (R. T. pp. 208-210).

For more than two years after the subject escrow closed in September, 1959, until the time of default in December, 1961 (Pretrial Conference Order, par. 10, C. T. p. 95f), Alan Realty Company continued to act as agent for its 31 investors. In such capacity it retained the subject promissory note and deed of trust in its vault, it received payment from the Bowers and subsequently from the bankrupt (after it acquired the property) and it handled the accounting and depositing the moneys collected for many of the original 31 investors (R. T. pp. 193-194, 203-04, 225-26, 238-40, 106-107; Crane Ex. 2 and Crane Ex. 8).

And yet, in the face of this undisputed evidence, the Referee held that the promissory note and deed of trust were null and void!

B. Facts re Appellants' Interest in
Proceeds of Sale of Escondido No. 3.

The relevant facts which go to the only real question in this case: whether or not appellants are entitled to all of the net proceeds received from the sale of Escondido No. 3 until their admitted obligation is paid off, are as follows:

On or about June 11, 1960, by written agreement (in evidence as the second Crane Ex. 3), the Bowers agreed to sell certain of their assets, including Escondido No. 3, to Messrs. Horwitz and Harris or their nominee. On or about July 1, 1960, by written escrow instructions, the bankrupt, Western Growth Corporation, was named as nominee and thereafter took title to such assets, including Escondido No. 3 (Pretrial Conference Order, par. 18, C. T. 95e; second Crane Ex. 3).

There is a factual dispute over whether or not Western Growth Corporation, the bankrupt, purchases Escondido No. 3 subject to the subject deed of trust or expressly assumed same. In spite of the Referee's finding to the contrary (C. T. p. 67, Finding No. 19) the uncontradicted evidence clearly and unequivocally demonstrates that the bankrupt expressly assumed the obligation to pay the promissory note secured by the subject deed of trust.

Thus, one of the documents in evidence forming a part of second Crane Ex. 3 is an addendum dated June 27, 1960, to the contract dated June 11, 1960, between Bower and Messrs. Horwitz and Harris, the key provision of which paragraph 14 provides as follows:

"It is understood and agreed that any responsibility on the part of the second parties [defined in the June 11, 1960 agreement to be the Bowers] to make any payments whatsoever on account of the purchase price of contracts of sale due or interest payment or amortization of principal payments or any or all of them, shall cease and terminate with respect to all personal and real property, including the 14+ acres mentioned in par. 5 of the master agreement as of June 11, 1960 [i. e. Escondido No. 3]. The first parties [Horwitz and Harris or nominee] shall accomplish same and hold second parties harmless from said payments accruing after said date." (emphasis added)

Since portions of the North County Escrow Company instructions between the original sellers of Escondido No. 3 and James A. Bower, as buyer (in evidence as second Crane Ex. 5), clearly demonstrate that the sale as consummated was an all cash sale (see short instruction dated August 28, 1959, and closing escrow statements to James A. Bower and the sellers, Mr. and Mrs. Lepman) the express reference in par. 14 of the addendum quoted above to the obligation concerning Escondido No. 3 must be to the obligation secured by the subject deed of trust. Thus, Western Growth Corporation, as nominee, was bound by the express agreement of its nominors to satisfy the Bowers' obligation under

the subject note and deed of trust. 1/

That Western Growth expressly so assumed is further evidenced by the fact that from the date of its acquisition of the property in the Spring or Summer of 1960, until it defaulted around December 31, 1961, it made all payments due on the subject note and deed of trust (Pretrial Conference Order, par. 10, C. T. p. 95f; R. T. 106). 2/

The only other relevant fact which must be considered on the question of the appropriate disposition of the proceeds derived from the sale of Escondido No. 3, is that in approximately August, 1960, 16 of the original 31 investors accepted, in return for an assignment to the bankrupt of their undivided interests in and to

1/ Of course, it is settled in California that the construction placed upon a written instrument by the trier of fact is not binding on the reviewing court (Parsons v. Bristol Development Co., 62 Cal.2d 861, 402 P.2d 839 (1965)) where, as here, there is no conflict in the extrinsic evidence. This rule has been approved and applied by this Court in the recent companion cases of Bass v. Stuttman, Quittner & Treister, No. 20600 and Bass v. Gendel, Raskoff, Shapiro & Quittner, No. 20601 (reported in July 13, 1967 edition of Metropolitan News) holding that where no question of credibility involved both it and District Judge had right and responsibility to reexamine Finding and make independent judgment.

Accord: Diamond National Corp. v. Lee,
333 F.2d 517, 523 (9th Cir. 1964);
Costello v. Fazio, 256 F.2d 903 (9th Cir. 1958).

2/ The action of the bankrupt in making such payments is itself strong additional evidence that it assumed the obligation to satisfy the note and deed of trust. See, e. g., Andre v. Stilson, 37 Cal. App.2d 334, 99 P.2d 557 (1940); Banta v. Rosasco, 12 Cal. App.2d 420, 55 P.2d 601 (1936); Dodds v. Spring, 174 Cal. 412, 163 Pac. 351 (1917); Merchants Holding Corp. v. Grey, 6 Cal. App.2d 682, 45 P.2d 253 (1935); Andrews v. Robertson, 177 Cal. 434, 170 Pac. 1129 (1918); Hibernia Savings & Loan Society v. Dickenson, 167 Cal. 616, 140 Pac. 265 (1914).

the subject promissory note and deed of trust, certain unsecured notes of the bankrupt (Pretrial Conference Order, par. 9, C. T. p. 95e).

IV

SPECIFICATION OF ERRORS

Appellants specify the following errors of the Court below which they rely upon herein:

A. That Judge Clarke erred in failing to reverse the order and judgment of Referee Champlin entered on February 1, 1966 (C. T. p. 177), insofar as said order adjudged in Paragraph 6 thereof that the subject promissory note and deed of trust were null and void and of no force and effect. 3/

B. That said District Judge erred in failing to reverse said order and judgment of said Referee insofar as it adjudged in Paragraph 7 thereof that a trust concerning the subject note, and deed of trust and/or the real property involved in these proceedings does not now and never has existed.

C. That said District Court erred in failing to reverse said order and judgment of said Referee insofar as it determined in Paragraph 9 thereof that appellants have an aggregate interest of only 33/70 in the subject real property as security for the total indebtedness due to them.

3/ Written objections to the proposed form of Order and Judgment were timely filed by Appellants and appear in C. T. at p. 152.

D. That said District Court erred in failing to reverse said order and judgment of said Referee insofar as it determined in Paragraph 10 thereof that 37/70 of the proceeds from the sale of the subject real property shall be paid to the Trustee in Bankruptcy herein and become part of the bankrupt estate and be free of any lien of appellants.

E. That said District Court erred in failing to reverse said order and judgment of said Referee insofar as it adjudged in Paragraph 11 thereof that said Trustee, as successor in interest to the bankrupt estate, owns all of the right, title and interest in the said promissory note and deed of trust of the 16 persons who assigned and granted said interest, as more fully set forth by said Referee in his Finding of Fact No. 20.

F. That said District Court erred insofar as it failed to reverse and reject all of the Findings of Fact and Conclusions of Law entered by the Referee in this hearing on February 1, 1966, which were objected to by appellants in their written objections filed in respect thereto (C. T. p. 146).

G. That said District Court erred in failing to overrule the rulings of said Referee insofar as said Referee overruled appellants' objections to the proposed Findings of Fact and Conclusions of Law and order proposed by the Trustee in Bankruptcy and failed to enter the alternative findings requested by appellants (C. T. 146).

H. That said District Court erred in affirming the order of the Referee of February 1, 1966, and in determining in

his order (C. T. p. 233) that said Referee's Findings of Fact were not clearly erroneous and that said Referee's order was supported by the evidence and by the applicable law.

V

ARGUMENT

A. SUMMARY OF ARGUMENT

The argument which follows is divided into two basic parts:

Firstly, the Brief will treat the question of the validity of

the subject note and deed of trust and will demonstrate that:

- (i) There was a valid delivery thereof; and
- (ii) Milton N. White at all times acted as a dry

or passive trustee for the 31 investors, including certain of appellants herein, and, as such, took title to the subject note and deed of trust on their behalf.

Secondly, the Brief will analyze the question of the correct disposition of the net proceeds derived from the future sale of Escondido No. 3, and will demonstrate that:

- (i) The law is well settled that payment or release of an underlying debt, ipso facto, releases the security securing same;
- (ii) Neither the debtor nor the successor in interest to the debtor's land, who pays the underlying debt or secures its release, can keep the mortgage or trust deed lien alive

and assert same against any secured creditor who has an equal or superior lien therein.

(iii) That the result described in (ii) above is the same, whether or not the subsequent owner expressly assumes the secured debt or purchases subject to said debt;

(iv) That the doctrine of equitable prevention of merger is not here applicable.

Appellants turn now to a fuller elucidation of these arguments.

**B. THE SUBJECT DEED OF TRUST
AND PROMISSORY NOTE ARE
VALID AND IN FULL FORCE
AND EFFECT.**

As indicated above, Referee Champlin held that the subject promissory note and deed of trust were null and void and of no force and effect by reason of his prior determination that (i) a valid delivery thereof was lacking and (ii) no legal trust was created by designating Milton N. White as trustee thereon.

That these determinations were patently erroneous under applicable law is clearly demonstrable.

1. There Was Valid Delivery of the
Subject Promissory Note and
Deed of Trust.
-

The following principles are determinative of the question of whether or not the subject note and deed of trust were validly

delivered:

(a) It is well settled under California law that the recordation of a legal instrument at the request of the maker constitutes prima facie evidence of delivery with intent presently to convey or create the interest set forth therein. See Butler v. Butler, 188 Cal. App. 2d 228 at 233, 10 Cal. Rptr. 382 (1961) and authorities cited therein. Although this presumption of delivery is rebuttable, the burden of refutation rests on the party denying delivery. Butler v. Butler, ibid. Moreover, "recordation coupled with manual delivery raises a strong presumption, which can be overthrown only by very clear proof". 2 Witkin, Summary of California Law, Real Property, §55 and cases cited therein.

In this case, the evidence shows both the recordation of the subject deed of trust, and, pursuant to its terms, the delivery of it and the subject promissory note to the Alan Realty Company. Thus, the strong presumption of effective delivery is presented.

This strong presumption obviously has not been overcome by the Trustee in Bankruptcy. He did not even see fit to call Mr. Bower, the one man who could conceivably rebut the presumption to testify. ^{4/} The Trustee's only argument is that since the Alan Realty Company received a brokerage commission from the Bowers,

^{4/} Bower obviously was in no position to deny effective delivery. That he thought the note and deed of trust were valid and subsisting clearly appears from the fact that he negotiated a contract with the nominors of the bankrupt corporation, requiring them to take over, satisfy and indemnify him from said obligation. (See pp. 8-10, supra).

it therefore must have acted solely as the Bowers' agent throughout this transaction and, hence, the admitted delivery of the note and trust deed to Alan Realty Company was legally insufficient. This argument is not only an obvious non sequitur, it also is clearly erroneous for a number of reasons:

Firstly, the evidence in this case clearly shows that Alan Realty Company solicited \$210,000 from the original 31 lenders, who were its clients, and thereafter serviced the note and trust deed for them by receiving payments from the Bowers (and later from Western Growth), keeping the accounting regarding same and depositing for or transmitting such payments to the lenders. It thus clearly acted as agents for the 31 lenders throughout the entire transaction.

Secondly, it is a common and well-recognized practice for a broker to act as a dual agent in a sale or loan transaction. As noted in 9 Cal. Jur. 2d, Brokers, §3:

"Usually a broker is a special agent. The chief characteristic that distinguishes him from other classes of agents is that while he is ordinarily held to be the agent of the party who first employs him, he acts as a negotiator or intermediary between both parties to a transaction. Under certain circumstances, however, he may act as the agent of both parties. Another distinguishing feature is that a broker's compensation or commission is not necessarily paid by his principal. He may secure

his fee from the person from whom he negotiates
and nevertheless maintain his character as agent
of the person who employs him, subject to the
ordinary rules of good faith and disclosure to his
principal." (Emphasis added). See also Stephens
v. Ahrens, 179 Cal. 743, 178 Pac. 863 (1919).

It is therefore clear from the foregoing, that the Alan Realty Company at all times herein did act as agent for the original 31 lenders and (although it is in no way necessary to establish this agency) delivery to Alan Realty clearly constituted delivery to plaintiffs.

(b) It is clear from the subject escrow instructions (Crane Ex. 3) and the subject deed of trust (Crane Ex. 2) that White and the Bowers specifically agreed and directed that delivery of the deed of trust be made to Alan Realty Company. It is clear from the applicable cases that such an agreement, when executed, conclusively establishes the requisite delivery, whether or not at that time Alan Realty Company was acting as agent for the 31 investors. See e. g.:

City Lumber Co. v. Brown, 46 Cal. App. 603, 189 Pac. 830 (1920). ("It will not be disputed that where the grantee directs or agrees that the deed may be left for him with a third party the delivery to the latter is equivalent to a delivery to the grantee, the third party being thus constituted as grantee's agent for such purpose.");

Brereton v. Burton, 27 Cal. App. 2d 464, 81 P. 2d 238

(1938). ("It is true that a valid and binding delivery of a deed of conveyance of real property may be accomplished by handing it to a third party when it satisfactorily appears that both the grantor and the grantee intended that such delivery of the instrument would result in a present transfer of title to the grantee. (Stone v. Daily, 181 Cal. 571 (1919) [185 Pac. 665]; 9 Cal. Jur. 172, §65.)");

Handley v. Guasco, 165 Cal. App. 2d 703, 332 P. 2d 354 (1958);

Hibberd v. Smith, 1 C. U. 554;

Annotation, 74 A. L. R. 2d 992, "What constitutes acceptance of deed of grantee"; and finally

(c) Since "It is well settled that an escrow agent is the agent of both parties to" the escrow, Bonaccorso v. Kaplan, 218 Cal. App. 2d 63, at 69, 32 Cal. Rptr. 69 (1962), the Bowers admitted delivery of the subject note and deed of trust to Wilshire Escrow Company standing alone was delivery to the agent of the 31 investors, and hence in itself legally effective.

2. Milton N. White At All Times Acted
As a Dry Or Passive Trustee For
the 31 Investors and, As Such, Took
Title to the Note and Trust Deed On
Their Behalf.
-

Both Referee Champlin and (apparently) Judge Clarke, failed to appreciate the nature of the "trust" created by the subject transaction. The Referee looked for a trust res, a trust agreement and the other elements that one looks for when one deals with a

traditional trust. He thereby ignored the fact that what is present in the instant case is nothing more nor less than a dry or passive trust, i. e., one in which the trustee (Milton N. White) had no duties whatsoever other than to take and hold title for a time in and to the subject note and deed of trust on behalf of the 31 investors.

A discussion of this kind of trust appears in 48 Cal. Jur. 2d, Trusts, §6, as follows:

"A 'dry' trust is one in which the trustee has no actual responsibilities and no active duties to perform. Thus, an agreement by which one party is to hold for the use of another, but under which the trustee is not assigned any duties, is not an active trust, but is a simple or dry trust. Or where the trustee is the mere depositary of the naked title, charged with no duty and without power to take possession, or manage, or exercise any control over the property, it is a dry trust. . . ."

(Emphasis added).

And in 4 Witkin, Summary of California Law, Trusts, §17, the author states:

"It was also clear, under CC 857, that a passive or dry trust to hold property and its proceeds, the trustees having no actual duties to perform, was void. [Citing a case].

"In 1929, CC 857 and CC 847 were repealed,



and CC 2220 was amended to provide: 'A trust in relation to real and personal property, or either of them, may be created for any purpose or purposes for which a contract may be made.' Under this section, even a passive trust would be valid. [Citing a case]. "

That this is a correct statement of the law appears from the following cases: Engineering etc. Corp. v. Longridge Investment Co., 153 Cal. App. 2d 404, 409, 314 P. 2d 563 (1957); Bariffi v. Longridge Development Co., 156 Cal. App. 2d 583, 590-91, 320 P. 2d 192 (1958). And see also Craven v. Dominguez Estate Co., 72 Cal. App. 713, 237 Pac. 821 (1925); Shaw Estate, 198 Cal. 352, 246 Pac. 48 (1926); Ringrose v. Gleadall, 17 Cal. App. 664, 121 Pac. 407 (1911).

Thus, Referee Champlin clearly erred in holding (as did Judge Clarke, if he affirmed same) that the subject note and deed of trust were not valid and subsisting instruments. This being the case, appellants will turn in the balance of this Brief to an analysis of real question presented: whether or not they are entitled, as they claim, to all of the net proceeds derived from the sale of Escondido No. 3 up to an amount necessary to pay off the admitted indebtedness to them.

C. THE TRUSTEE IN BANKRUPTCY IS NOT ENTITLED TO ASSERT THE CLAIMS OF THE 16 ORIGINAL INVESTORS WHO ASSIGNED THEIR INTEREST IN THE NOTE AND DEED OF TRUST TO THE BANKRUPT IN 1960.

1. Payment Or Release Of An Underlying Debt Ipsa Facto Releases the Mortgage.

The law is well settled, and it is uniformly recognized, that payment of the underlying debt secured by a mortgage or deed of trust releases the mortgage or deed of trust ipso facto and nothing further need be done to cancel said debt and said security. And, of course, the payment of the obligation need not be in cash for "a release of the mortgage debt for any reason satisfactory to the mortgagee has the same effect as payment". 3 Powell on Real Property, §§ 460 and 457.

Accord: 36 Am. Jur. Mortgages, §406: ("The general rule is that payment of the mortgage debt ipso facto eo instante extinguishes the mortgage for the benefit of whoever is owner of the property at the time of payment. Indeed, on the ground that the incident cannot survive the principal, it is frequently stated that anything which operates to extinguish the debt necessarily operates to discharge the mortgage.");

4 American Law of Real Property, §§ 16.160 and 16.167 (stating that authorities unanimously hold that payment

paid the trust ceased, and the estate of the trustees ceases");

Dutton v. Warschauer, 21 Cal. 609 (1863) (holding, the character of a mortgage, as a mere security, was not changed by default in payment of the debt secured and that payment after default operated as an extinguishment of the lien equally as payment at the maturity of the debt.);

McMillan v. Richards, 9 Cal. 365 at 411-12 (1858) (holding, "the mortgage being a mere security for a debt, it must follow that payment of the debt, whether before or after default, will operate as an extinguishment of the mortgage.").

2. The Landowner Who Pays the
 Underlying Debt or Secures Its
 Release Cannot Keep the Mort-
 gage Lien Alive.

It is equally clear that the landowner who reacquires the property free from the mortgage or deed of trust by payment or release of the underlying debt, cannot keep extant the mortgage interest which is automatically extinguished by payment.

The rule is stated in 5 Tiffany on Real Property, §1482, that, while the doctrine of merger generally turns on the intention or interest of the party in whom both interest has merged, there are certain circumstances under which neither consideration can be given effect.

"Such is the case when one who is primarily
liable for the mortgage debt acquires the debt with

the lien incidental thereto, 'takes an assignment of the mortgage' as it is usually expressed. One who is primarily liable for a debt cannot acquire the debt, that is, a claim against himself and assert that the debt is still outstanding. The same person cannot be debtor and creditor, and the effect of his acquisition of the debt is to render it no longer extant. So when the person whose debt is secured by a mortgage, ordinarily the mortgagor himself, acquires the debt with its incidental lien, the debt being discharged, the mortgage lien is extinguished." (Emphasis added).

3 Pomeroy's Equity Jurisprudence, §796 (5th Ed.) states the rule as follows:

"An owner of a fee subject to a charge, who is himself the principal and primary debtor, and is liable personally and primarily for the debt secured, cannot pay off the charge, and in any manner, or by any form of transfer, keep it alive. Payment by such a person and under such circumstances necessarily amounts to a discharge. The encumbrance cannot be prevented from merging by an assignment taken directly by the owner himself or to a third person as trustee. This rule applies especially to a mortgagor who continues as the primary and principal debtor. The rule also applies to the grantee of a mortgagor

who takes the conveyance of the land subject to the mortgage, and expressly assumes and promises to pay it as part of the consideration." (Emphasis added).

Mr. Pomeroy cites numerous cases in support of the above statement of the law.

Additional cases may be found in the Annotation in 46 A. L. R. p. 322 at 329, where the rule is stated:

"Where the owner of the fee acquires a paramount mortgage the payment of which he has theretofore assumed, equity will not keep the charge alive, whatever may be his intention or the form of the transfer of the mortgage to him."

And in 9 Thompson on Real Property, §4799, the author writes that when a mortgage debt is paid by one bound to pay it, such payment operates as a discharge and the mortgagor will not be allowed to hold it as a "subsisting encumbrance". The author further writes, in line with that rule, that:

"A mortgagor is not allowed, after having obtained a transfer of a first mortgage made by himself, to set it up against another mortgage of later date which he has also made. . . ."
(Emphasis added).

Accord: Coote, Mortgages (9th Ed.) 1439-1450;

Osborne on Mortgages, 861 (1951);

3 Powell, Real Property §459.

That this is the rule in California is clear from the case of Dowds v. Spring, 174 Cal. 412, 163 Pac. 351 (1917) where the court held that where the subsequent grantee of a mortgagor paid the mortgage, the payment of the debt extinguished the mortgage and prevented said grantee from taking an assignment of the mortgage to himself and thus keeping it extant.

A California case, on all fours with the instant case, is Wilson v. McLaughlin, 20 Cal. App.2d 608, 67 P.2d 710 (1937). There, A gave to B 6 promissory notes in the face amount of \$5,000 each, secured by a single deed of trust on certain real property. Following the death of B, her estate, including the 6 notes, was distributed in equal shares to her two daughters, plaintiff and C, the wife of A. After the death of B, A conveyed to C the real property which was subject to the deed of trust. Thereafter, plaintiff brought an action to quiet her title to her 3 notes and the security. The trial court held that C's interest as beneficiary under the deed of trust merged into her title to the property and that the effect of the transaction was to extinguish the debt to the extent of \$15,000, thus leaving plaintiff as the owner of 3 of the notes having an unpaid balance of \$15,000 fully secured by the deed of trust. The Appellate Court affirmed in the following significant language:

"Upon their appeal the executors contend
that there was no merger or partial extinguishment

of the debt, and that therefore the estate owns a one-half interest in the whole thereof. The trial court correctly held that the undivided interest of Mrs. Nelson [C] as beneficiary under the trust deed was merged in the fee title which she received from her husband [A]. This resulted by operation of law. There are many instances in which equity will intervene to prevent a merger of separate estates held in a single ownership, but they are all cases in which some right or just advantage would be lost to the owner of the two estates if the lesser were merged in the greater. [Citing numerous cases] The principle of these equitable rules has no application to the facts in evidence. . . .

"The executors point out that if no merger took place, by reason of the extinguishment of one-half of the debt, the estate would be entitled to receive one-half of the proceeds of the sale of the property under a foreclosure of the trust deed, whereas under the judgment, which declares that the estate's interest as beneficiary has been merged in the legal title to the property, the lien of the trust deed remains in full effect, and the entire property stands as security for the payment to plaintiff of the unpaid balance of \$15,000. But this status, established by the judgment, is as it should be. Mrs.

Nelson obligated herself to pay the entire debt of \$30,000, which means that she agreed to pay plaintiff the principle sum of \$15,000, which was plaintiff's share of the notes. If the property had been sold for an insufficient amount to liquidate the debt in full, Mrs. Nelson would have been liable for the deficiency. Her obligations have not been increased by giving effect to the merger of the beneficial interest with the fee, and there is no reason why they should be diminished, if they could be diminished by a refusal to give effect to the merger." (Emphasis added)

An out-of-state case which is also on all fours with the instant case is Malinoski v. Mekody, 48 N. Y. S. 2d 940 (1944), affirmed 269 A. D. 717, 53 N. Y. S. 2d 758, the facts of which were as follows:

Malinoski, the owner of certain land, gave a \$4,000 bond and mortgage to one Bucaniec covering two parcels of land containing 79 acres and 150 acres respectively. Sometime thereafter Bucaniec assigned the bond and mortgage to Bronner, who on the same day re-assigned the bond and mortgage to Bucaniec and Kuehnle. This re-assignment stated that Bucaniec's interest in the mortgage amounted to the sum of \$1,200 and Kuehnle's interest to the sum of \$2,800. A number of years later Malinoski, the landowner, conveyed to Mekody a portion of his farm consisting of 150 acres, Mekody assuming the payment of the mortgage

indebtedness. Shortly thereafter, Bucaniec, the assignee of \$1,200 of the \$4,000 mortgage indebtedness, signed an instrument releasing Malinoski from the mortgage lien and assigning to him the 79-acre parcel covered by said mortgage. Bucaniec also signed an instrument purporting to assign to Malinoski all of his rights, title and interest in the mortgage.

Thereafter, two actions were commenced:

Action No. 1 by Malinoski to foreclose the mortgage on the 150 acres of land only previously conveyed by him to Mekody and Action No. 2 by Kuehnle to foreclose the entire mortgage.

The court held as follows:

1. "[T]hat, with the assignment of the mortgage by Bronner to Bucaniec and Kuehnle, the two latter persons become the holders of coordinate participation in the mortgage debt . . .";
2. That:
"Therefore, the release to Malinoski from Bucaniec could do no more than to release the 79 acres from the lien of Bucaniec's portion of the indebtedness and could not affect the Kuehnle lien"; and
3. That:
"The total effect of these two instruments . . . was to merge the Bucaniec mortgage interest (as assigned to Malinoski) with the superior title of the latter in the 79 acres so

that then Malinoski held such parcel free from the lien of the Bucaniec \$1,200 participation in the mortgage but Kuehnle still had a lien on the full 229 acres formerly owned by Malinoski as security for her portion of the indebtedness." (48 N. Y. S. 2d 946) (Emphasis added)

Thus, Malinoski also stands for the proposition that where several of a class of secured creditors are paid off or release their claim and purport to assign their individual interest in the security to the owner of the property, the debt and the security is extinguished to that extent and the remaining creditors are entitled to utilize the full net proceeds derived from the sale of the secured property until the underlying debt has been fully paid off.

Another important case is Liddle v. Lechman, 114 Colo. 189, 163 P.2d 802 (1945). The relevant facts of that case were as follows: Plaintiff purchased certain land from the former owners thereof after the land had been conveyed to the beneficiary under a deed of trust pursuant to foreclosure proceedings. The deed given to said beneficiary as a result of said foreclosure proceedings granted to said beneficiary certain water rights. Thereafter, plaintiff paid the underlying debt secured by the deed of trust and got an assignment of the certificate of purchase from the foreclosing beneficiary. The court held that plaintiff was not entitled to assert the water rights granted to the beneficiary as a result of the foreclosure

proceeding, declaring (p. 809):

"[W]e are convinced that the law is rather definitely established that where the payment of a lien indebtedness, in no matter what form it is evidenced, is made to the holder thereof, by parties who are personally and primarily liable therefore and whose duty it is to pay it, such a payment, no matter what form the indebtedness assumed, operates to discharge any lien. The lien becomes completely destroyed for all purposes. Under such circumstances the persons paying the lien indebtedness are not entitled to be subrogated to the rank of the holder of the lien, there is no equitable assignment to them, and even though they received a formal assignment, the lien cannot thereby be kept operative but becomes wholly merged and ended and the loan and the evidence thereof becomes absolutely extinguished." (Emphasis added)

Yet another case closely analogous to the instant situation is Bartlett v. Wade, 66 Vt. 629, 30 Atl. 4 (1894). There, the mortgagor gave a mortgage to his creditor to secure 18 promissory notes given to evidence certain indebtedness. Thereafter, four of the promissory notes were purchased by the plaintiff from the creditor. Plaintiff had the mortgagor purchase a fifth promissory note from the mortgagee, the mortgagor acquiring same under the

guise of paying off one of the mortgage notes. In an action brought to foreclose the mortgage, the court held the plaintiff was not entitled to receive out of the mortgage foreclosure proceeds payment of the fifth promissory note, holding that the acquisition by the mortgagor thereof discharged said note and released the mortgaged lien on the property to that extent.

Relevant English authorities also support the rule contended for by appellants herein:

Otter v. Vaux, 6 De. G.M. and G. 638,

69 Eng. Rep. 943 (1856);

Johnson v. Webster, 4 De. G.M. and G. 471,

43 Eng. Rep. 592 (1854).

3. The Subject Deed of Trust Was Assumed By the Bankrupt But the Result Is the Same Even If It Purchased Escondido No. 3 Subject to Said Deed of Trust.
-

It clearly has been demonstrated that Western Growth Corporation, the bankrupt, assumed the Bowers' obligation to pay off the subject note and deed of trust when it purchased Escondido No. 3 in 1960 (See pp. 8 - 10, supra) ^{5/}. But, even assuming arguendo the said purchase was made by the bankrupt "subject to"

^{5/} Since the subject note and deed of trust are clearly purchase money instruments, the bankrupt's assumption did not increase its exposure because in any event, under C. C. P. §580b, only the property is available to satisfy the debt. Weaver v. Bay, 216 Cal. App. 2d 559, 31 Cal. Rptr. 211 (1963); Stockton Sav. & Loan Bank v. Massanet, 18 Cal. 2d 200, 114 P. 2d 592 (1941).

the trust deed at bar, the same rule of law is applicable, for it is equally well settled that where the subject-to grantee takes an assignment of the mortgage "the debt secured by the mortgage is held to be extinguished . . ." Osborne on Mortgages, p. 700 (1951) and authorities cited at note 27 (Emphasis added).

95 A. L. R. 89, 107 ("As a general rule, where a purchaser of land subject to a mortgage takes an assignment of the mortgage, the debt secured by the mortgage is extinguished . . .");

37 Am. Jur. , Mortgages, §1324 ("It is a well established rule that where a purchaser of mortgaged property who has assumed payment of the mortgage takes an assignment of the mortgage and the debt secured, the debt is extinguished and the personal liability therefor cannot be enforced. The same result has been reached in the case of a person who has purchased the land subject to the mortgage." (Emphasis added));

Goodman v. Goodman, 127 Ohio St. 223, 187 N. E. 777 (1933) (holding that an accommodation maker of a note secured by real estate was discharged from liability where one who had acquired the real estate subject to the mortgage took an assignment of the note and mortgage, the court holding that such an assignment discharged the mortgage debt since the mortgage was merged in the fee.)

The error of the Trustee's attempted distinction between a "subject to" and assuming grantee can best be demonstrated by reviewing the following hypothetical cases:

CASE 1 - Assume that A, a landowner, borrows \$50 from

B and \$50 from C and gives in return to evidence the debt a promissory note in the sum of \$100 payable jointly to B and C secured by a mortgage on his real property also jointly in favor of B and C. Assume further that A pays B \$50 and receives in return from B an "assignment" of B's interest in the note and mortgage. Assume finally that in a foreclosure action brought by C the mortgaged real property brings \$50 at public sale. All of the authorities reviewed above hold or clearly indicate that C is entitled to payment in full out of the net sale proceeds of the \$50 lent by him to A and that A cannot set up B's interest in the mortgage against C.

CASE 2 - Assume the facts are the same as in Case 1 with the additional fact that A sells the property to D, who specifically assumes the mortgage, D thereafter paying \$50 and taking an assignment from B. Again, all of the authorities previously reviewed clearly and unequivocally stand for the proposition that C is entitled to a payment in full of the moneys lent by him to A, from the net proceeds derived from the sale of the mortgaged property.

CASE 3 - Case 3 is identical to Case 2, except D, rather than assuming the mortgage, takes the mortgage property subject to the mortgage. The Trustee has cited no authority whatsoever which would support a different holding in Case 3 from the holdings required in Cases 1 and 2 and both reason, justice and the authorities reviewed above require the same disposition in Case 3 as in the first two cases.

In all three cases the present landowner of the property

has freed the property from a portion of the lien by paying off the indebtedness to B and yet seeks to keep that portion extant in order to dilute the interests of C, one of the original lenders, upon C's foreclosure of the remaining portion of the lien.

Under the facts of our three hypothetical cases (assuming a purchase dollar situation), the landowner, if he prevails, is out-of-pocket only \$25, the \$50 (paid to B) less recoupment of the \$25 (one-half of the net proceeds of foreclosure sale) while the surviving lender, C, has recovered only \$25 of the \$50 he has lent. But as shown above, in Cases 1 and 2 the law requires that the surviving lender be made whole: Reason, equity and precedent likewise require that the same result be reached in Case 3. Therefore, even assuming that which is not a fact: that the bankrupt herein purchased Escondido No. 3 subject to the deed of trust at bar, it still is not entitled to assert, as Referee Champlin held, and Judge Clarke affirmed, a claim to 37/70 of the net proceeds derived from a sale of Escondido No. 3.

4. The Equitable Prevention-of-Merger Doctrine Is Not Here Applicable.

The Trustee contended below that the rule that a court of equity can prevent a merger is applicable herein. This rule, however, has never been made available, except in this case, to permit a landowner to dilute another's security. In the past it has only been used in behalf of a senior lienor to prevent a junior or subsequent lienor from taking advantage of and reaping a windfall

from the senior encumbrancer when he acquires the mortgaged land from the landowner.

Thus, Osborne on Mortgages states:

"It hardly needs to be stated that the preservation of the mortgage is solely for foreclosure purposes and, even for that purpose, only as to the intervening liens or other interests." (Emphasis added) Osborne, Mortgages, p. 773, n. 39, see also p. 774;

See also the similar statement found in 5 Tiffany on Real Property, §1482, quoted supra pp. 23-24.

33 Cal. Jur. 2d Mortgages, §§ 284-286;

37 Am. Jur. Mortgages, §1190, et seq.

The distinction between the use of the equitable rule of non-merger to prevent subordinate lienors from gaining a windfall and the instant case is well illustrated in the following quote from 1 Witkin, Summary of California Law, pp. 735-36:

"A mortgage may also be discharged by merger. Suppose A mortgages to B, then sells to B. B now has the entire legal and equitable interest in the property, and ordinarily the lien of the mortgage will be merged with the title. (Anglo etc. Bank v. Field (1908) 154 Cal. 513, 98 P. 267; Jenson v. Burton (1931) 117 C. A. 66, 3 P. 2d 324; cf. Mortgage Guarantee Co. v. Lee (1943) 61 C. A. 2d

367, 143 P.2d 98 [no merger unless entire legal and equitable estate in one person].)

"If this rule were invariable it would sometimes result in injustice to the mortgagee. Thus, suppose A, after giving the mortgage to B, gives a second mortgage to C, and then sells to B. If B's lien is merged in this title, C becomes the first mortgagee, and B must pay his claim before satisfying his own prior lien. If the value of the land is less than the amount of both liens, B will suffer a loss. Because of this possibility, it will be presumed that the mortgagee intends to keep his mortgage alive after sale, even after the instrument has been cancelled; and equity will prevent a merger when this is necessary to protect the interests of the mortgagee. (Sheldon v. La Brea etc. Co. (1932) 216 C. 686, 15 P.2d 1098.) Thus, in Hines v. Ward (1898) 121 C. 115, 53 P. 427, an insolvent mortgagor deeded the property to the mortgagee in satisfaction of the mortgage. The mortgagor represented that there was no other lien, and the mortgagee consented to cancellation of the instrument. There was, in fact, a judgment lien of a third party. Held, the discharged mortgage would be kept alive in equity and made prior to the intervening lien. (See generally 95 A. L. R. 628; 148 A. L. R. 816.)" (Emphasis in part added).

Witkin then reviews the landmark California case of Wilson v. McLaughlin, digested supra, p. 26 and concludes that merger was proper in that case since "there were no equitable circumstances to prevent merger . . .".

Likewise readily distinguishable are the cases relied upon by the Trustee since they fall within the equitable prevention of merger category.

Thus, in Matzen v. Schaeffer, 65 Cal. 81, 3 Pac. 92 (1884), all the court holds is that a purchaser of land subject to a mortgage who pays off that mortgage as part of the purchase price is entitled to assert that mortgage against the purchaser of the property at an execution sale based upon a judgment entered after the date of the execution of the original mortgage for otherwise the purchaser at the judgment sale would be given a superior position against the person who paid off the senior lien. It is important to note that in Matzen, the court specifically states "there is no equitable ground on which the [judgment sale purchaser] could object to the mortgage lien being kept alive for the protection of [the purchaser of the property who paid off the mortgage indebtedness] interest" (p. 83). Just the opposite, of course, is true in the instant case where the effect of the Trustee's argument that merger did not occur would be to dilute the security interest of appellants by more than 50%.

Also, readily distinguishable is Jameson v. Hayward, 106 Cal. 682, 39 Pac. 1078 (1895) where the court simply holds that one tenant in common of an estate for years who had acquired the

reversionary interest therein is not barred by the doctrine of merger from asserting his tenancy in common position in a partition action.

Thus, it is clear from all the authorities that the relief-from-merger doctrine has no application whatsoever where, as in the instant case, the landowner satisfies a portion of a mortgage obligation and then attempts to keep that obligation alive to dilute or defeat the remaining portions of that mortgage interest.

VI

CONCLUSION

That the Trustee in the instant case sought and received from Referee Champlin and Judge Clarke a windfall for all those unsecured creditors of Western Growth Corporation who had nothing whatsoever to do with Escondido No. 3, is clear. For the effect of the order below will be to take from the appellants more than one-half of the net proceeds from the sale of Escondido No. 3 which are the only source from which their indebtedness can be paid and give this money to the general unsecured creditors. But as a result of the swap by 16 of the original 31 secured creditors, the secured obligation of the bankrupt in respect to the subject note and deed of trust has already been reduced more than half. 6/

6/ That such a happening is of real value to the bankrupt is easily demonstrable by the following hypothetical:

Assume that the outstanding indebtedness secured by the
(continued)

Consequently, now any excess of net sale proceeds from Escondido No. 3 over and above the \$84,000 some odd dollars plus interest necessary to pay off cross-respondents will go to the unsecured creditors, whereas before the swap there would be nothing left for the unsecured creditors, unless the secured property produced net proceeds equal to the \$210,000 less the amounts paid on the subject trust deed before the swap. Thus, the unsecured creditors already have gotten their benefit from the swap for, any excess over \$84,000 plus interest will be distributed to them pro rata. To permit such unsecured creditors in addition to share in more than one-half of the net proceeds derived from the sale of Escondido No. 3 is to award them with an unfair and illegal windfall, not countenanced by any authority.

We ask this Court to so hold.

Respectfully submitted,

GREENBERG & GLUSKER
and RICHARD H. FLOUM

By: RICHARD H. FLOUM
Attorneys for Appellants.

6/ (continued) existing loan was \$200,000, and that the 16 assignors assigned their claim against the bankrupt or Bower, as the case may be, in an amount of \$100,000. The bankrupt was then in a position to secure substantial additional moneys if it sought to borrow against Escondido No. 3 by reason of the fact that it was now encumbered by a lien securing an outstanding indebtedness of less than half of the original indebtedness. Surely, the bankrupt having obtained this important economic advantage, should not be permitted at the same time to assert that it can dilute the remaining creditors' lien by keeping extant its own or Bowers' indebtedness! It is of more than passing interest to note, that by a similar device the bankrupt was able to free as of March 1, 1961, approximately \$500,000 worth of secured collateral notes (R. T. 116-117).

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Richard H. Floum

RICHARD H. FLOUM

APPENDIX "A"

<u>Exhibits</u>	<u>Identified</u>	<u>In Evidence</u>
Crane Ex. 1 (Promissory Note)	24	Received p. 25
Crane Ex. 2 (Trust Deed)	26	Received p. 26
Crane Ex. 3 (Bower-White Escrow Instructions)	28	Received p. 28
Crane Ex. 4 (Short Form Escrow Instructions)	28	Received p. 29
Crane Ex. 5 (Judgment by Court After Default)	30	Received p. 30
Crane Ex. 6 (Application of Trustee to Sell)	31	Rejected p. 32
Crane Ex. 7 (Second Application of Trustee)	33	Rejected p. 34
Crane Ex. 8 (February 5, 1962 letter)	34	Received p. 35
Trustee's Ex. A	43	Received p. 43
Trustee's Ex. B	43	Received p. 43
Trustee's Ex. C	43	Received p. 43
Trustee's Ex. D (Letter)	43	Rejected p. 49
2d Crane Ex. 1 (Alan Realty Co. Accounting)	226-27	Received p. 227
2d Crane Ex. 2 (August 13, 1959 letter)	246	Received p. 247
2d Crane Ex. 3 (Bower Sale Documents)	278	Received p. 280
2d Crane Ex. 4 (Settlement Agreements 10/21/66)	281	Received p. 281
2d Crane Ex. 5 (Bower Purchase Escrow Documents)	281	Received p. 282
2d Trustee's Ex. A (Claim for Taxes)	287	Received p. 287

DEC 8 1967
No. 21810

IN THE

United States Court of Appeals

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WESTERN GROWTH CORPORATION,

Bankrupt.

STEPHEN CRANE, III,

Applicant and Appellant,

vs.

CURTIS B. DANNING, etc.,

Respondent and Appellee.

CURTIS B. DANNING, etc.,

Cross-Applicant,

vs.

LOUIS BENVENISTE, *et al.*,

Cross-Respondents and Appellants.

APPELLEE'S BRIEF.

FILED

DEC 7 1967

BUCHALTER, NEMER, FIELDS & SAVITCH,

By IRWIN R. BUCHALTER,

WM. B. LUCK, CLERK

727 West Seventh Street,

Los Angeles, Calif. 90017,

Attorneys for Appellee, Curtis B.

Danning, Trustee in Bankruptcy.

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APPELLEE'S BRIEF.

I.

JURISDICTION.

The United States District Court, Central District of California, is a Court of bankruptcy, and is vested with original jurisdiction in proceedings under the Bankruptcy Act. (Bankruptcy Act, §1(10), 2; 11 U.S.C. §1, 1(10), 11.) The District Court has jurisdiction to review the orders of the Bankruptcy Court. 28 U.S.C. 1334. This Court has jurisdiction to determine this appeal pursuant to the Bankruptcy Act, §24. (11 U.S.C. §47).

II.

PRELIMINARY STATEMENT.

Prior to August 31, 1959, James A. Bower and Melba Bower (hereinafter referred to as "Bowers") entered into an escrow to purchase $14\frac{1}{2}$ acres of real property in the City of Escondido, County of San Diego, State of California (known in these proceedings and hereinafter referred to as "ESC #3"). The Appellants are 15 of a total of 31 persons who made a total loan of \$210,000.00 to Bowers and the Bowers executed a Promissory Note in that amount and further executed a Deed of Trust on the $14\frac{1}{2}$ acre parcel as security for said note.

Thereafter, in August of 1960, 16 of the 31 persons owning \$111,000.00 of the full obligation (Appellants, the other 15 persons, participating to the extent of \$99,000.00) granted, transferred and assigned to the Bankrupt their respective interests in the loan, represented by the Bowers' note and Deed of Trust, and in lieu thereof, accepted certain unsecured Promissory Notes.

The Referee in Bankruptcy found that the Note and Deed of Trust were null and void but then determined that a fair, just and equitable division of the net proceeds from the sale of ESC #3 would be 33/70ths to the Appellants and 37/70ths to Curtis B. Danning, as Trustee.

The Referee's Order was affirmed by Judge Thurmond Clarke on February 10, 1967.

Appellant then perfected this appeal.

III.

STATEMENT OF THE FACTS.

There are very few facts which were controverted by either side and it is noteworthy that Appellants have failed in their opening Brief except in one or two instances (which will be pointed out to this Court) to attack or disagree with the Findings of Fact made by Hershel E. Champlin, Referee in Bankruptcy, acting in said matter for Ray H. Kinnison, the Referee in Bankruptcy. A summary of the uncontroverted facts and as set forth in the Findings of Fact and Conclusions of Law are that prior to August 31, 1959, the Bowers entered into an escrow to purchase 14½ acres of real property in the City of Escondido ESC #3.

At that time, thereafter, and during these proceedings, Alan Realty Company was a copartnership and a licensed real estate broker. Among the partners of Alan Realty Company were Ted Harris and David Belinkoff, who also became officers and directors of the Bankrupt, Western Growth Corporation (hereinafter referred to as the "Bankrupt") when it was incorporated in or about May, 1960. Bowers employed Alan Realty Company as their broker [Rep. Tr. pp. 190, 193] for the purpose of securing and soliciting 70 loans in the amount of \$3,000.00 for a total of \$210,000.00 to cover the subdivision of ESC #3 into 70 lots. Alan Realty Company was to collect and make periodic payments to the various lenders on the principal and interest of the loans at such time as such payments would become due. Inasmuch as ESC #3 was not yet subdivided into the 70 lots, the individual lots could not be given as security for each of the \$3,000.00 loans, and accordingly, and as an interim meas-

ure only, Alan Realty Company, together with its attorney, Milton White, decided:

(a) To open an escrow [Crane Ex. 6] at the Wilshire Escrow Company, at which each of the lenders would place their money; and

(b) Bowers would make their promissory note in the amount of \$210,000.00, payable to "Milton White, Trustee"; and

(c) Bowers would make and execute their Deed of Trust in favor of "Milton White, Trustee," in the amount of \$210,000.00 securing a promissory note in the same amount; and

(d) When Alan Realty Company had obtained the 70 loans, or \$210,000.00, the escrow would close and the loan proceeds be distributed as follows:

(i) To the North County Escrow Company as a portion of the purchase price owing by Bowers;

(ii) A portion to Alan Realty Company for their services for procuring the loans and for servicing the loans;

(iii) The costs of the escrow; and

(iv) The balance to the Bowers.

(e) When the subdivision was approved and ESC #3 divided into 70 lots, each of the lenders would then receive as security, by way of note and trust deed, one lot for each equivalent \$3,000.00 loan (Appellants' Br. p. 7).

Pursuant to the foregoing, Alan Realty Company, on behalf of Bowers, and as the agent of Bowers

[Rep. Tr. p. 193] did solicit and obtain 31 persons who, in varying multiples of \$3,000.00, deposited \$210,000.00 in the aforementioned escrow with a short form escrow instruction [Crane Ex. 4] whereby each of the 31 persons authorized the Escrow to accept the instructions of Milton N. White, Trustee. In accordance therewith, the Bowers executed a note [Crane Ex. 1] in the amount of \$210,000.00, dated August 31, 1959, payable to the order of Milton White, Trustee, and did further execute a Deed of Trust dated August 31, 1959, which, on its face, conveyed ESC #3 as security for the said Promissory Note and named Milton White, Trustee, as beneficiary [Crane Ex. 2]. Neither the Note nor the Deed of Trust sets forth on its face on whose behalf, if anyone, the said Milton White was acting as Trustee. On September 8, 1959, the Deed of Trust was recorded. At the same time the Escrow disbursed \$31,500.00 to Alan Realty Company for its services, as hereinabove set forth; \$67,500.00 paid to the North County Escrow Company as the balance of the purchase price due and owing by Bowers; \$110,182.20 was paid to Bowers and balance was used for costs of escrow and other costs in connection with the loan [Wilshire Escrow Company "Escrow Settlement"—Clk. Tr. p. 99].

The Escrow Company at that time delivered the \$210,000.00 Promissory Note to Alan Realty Company and not to Milton White. Upon recording, the County Recorder of San Diego County mailed the Deed of Trust, pursuant to written instructions on the document itself, to Alan Realty Company and not to Milton White. Alan Realty Company received and retained both documents [Exs. 1 and 2] in its possession, and

it is further undisputed that Milton White never received possession of either the Promissory Note or the Deed of Trust [Rep. Tr. p. 52]. None of the 31 persons who placed money in said escrow ever obtained possession of the Promissory Note or the Deed of Trust.

It is further admitted that ESC #3 was never subdivided and it is the uncontroverted testimony that there was never in existence an Agreement or Declaration of Trust whereby Milton White was designated as Trustee [Rep. Tr. p. 61] or whereby any person or persons were designated as the beneficiary or beneficiaries of any trust concerning ESC #3 in which Milton White was named as the Trustee; that he signed the Escrow Instructions upon the instructions of Alan Realty Company [Rep. Tr. pp. 65, 66 and 68]; nor did Mr. White know who the beneficiaries of such purported Trust might have been nor their interest therein [Rep. Tr. pp. 52, 217]. Mr. White never saw Crane Exhibit 4, the instructions of the lender(s) to the Wilshire Escrow Company [Rep. Tr. p. 83] nor did he receive instructions from anyone under which he was to operate as Trustee [Rep. Tr. p. 61].

Thereafter, on June 11, 1960, Bowers sold ESC #3 to the Bankrupt [Rep. Tr. p. 80] subject to any and all encumbrances thereon. Appellants suggest that there is a factual dispute over whether or not the Bankrupt purchased ESC #3 subject to the Deed of Trust or expressly assumed the same. This suggestion is completely without merit. First, it is the specific finding of the Referee [Findings of Fact and Conclusions of Law Par. 19, p. 10; Clk. Tr. p. 167] that the Bankrupt obtained title to the same *subject* to any

and all encumbrances thereon. Secondly, the matter was thoroughly covered by Paragraph III of the Pretrial Conference Order, and Appellee respectfully calls to this Court's attention that this was not a joint Pretrial Conference Order but was prepared by Appellants and stipulated to by both parties. Counsel cannot at this late stage repudiate its stipulation or the Court's Pretrial Order. (See Stipulations 46 Cal. Jur. 2d 9; *Allen v. Gardner*, 142 Cal. App. 2d 467, 298 P. 2d 585.) This portion of the Pretrial Conference Order set forth on page 95-e of the Clerk's Transcript reads as follows:

“III

“The following facts are admitted and require no proof:

. . . 8. That on or about June 11, 1960, by written agreement, the Bowers sold certain of their assets, including the real property, to certain persons or their nominee and that on or about July 1, 1960 by written escrow instructions, the Bankrupt was named as the nominee under said Purchase Agreement and thereafter the Bankrupt took title to the real property *subject to* all encumbrances of record in respect thereto.”

(Italics added for emphasis)

Accordingly, it is totally immaterial as to the meaning of Paragraph 14 of the Second Crane Exhibit No. 3 with reference to the contract of June 11, 1960. Appellee does not agree with the interpretation thereof placed on this exhibit as the same was a transaction in which the Bankrupt was far removed.

Appellee would like to comment at this time (and will show later in this brief similar instances) mis-

statements made by Appellants in their brief of various of the authorities cited by them. On page 10 of their brief they cite the companion cases decided by this reviewing Court of *Bass v. Quittner, et al.*, 381 F. 2d 54 (9 Cir. 1967) and specifically cite such cases as authority for their statement

“that where no question of credibility involved both it and District Judge had the responsibility to reexamine Finding and make independent judgment.”

The actual and exact quotation is as follows:

“The Referee’s ‘findings’ that the services were of no benefit to the estate were essentially conclusions which the district judge was competent to reexamine. (citing cases) Our court, too, is required to reexamine such *conclusions*, whether made by the Referee or the district judge.” (emphasis added)

The difference in the actual quotation and Appellants’ construction thereof is that this reviewing court is required to reexamine conclusions and not as inferred by Appellants the facts. Were it not for the stipulation of the parties in the pretrial conference order the finding of fact that the Bankrupt took title to the real property *subject to* all encumbrances of record might at best be a conclusion of law, but as a stipulation in the pretrial conference order it is a finding of fact and not a conclusion of law which this court should reexamine. Even if this court should reexamine this as a conclusion, this court will come to the same conclusion as the Referee and the District Court.

Appellee agrees with Appellants that the only other relevant fact was that a very short time later, August, 1960 and before any default, 16 of the 31 persons who placed the \$210,000.00 into the loan escrow and who participated in the full amount of the loan in the proportion of 37/70ths thereof and in the sum of \$111,000.00 (Appellants participating to the extent of 33/70ths thereof, \$99,000.00) granted and transferred to the Bankrupt their respective interests in the loan represented by the Bower Promissory Note and Deed of Trust and in lieu thereof, accepted certain unsecured promissory notes. Such assignment was made substantially in the form as set forth in Danning's Exhibit E [Clk. Tr. p. 102] and as found by the Referee, said assignment granted, assigned and transferred to the Bankrupt all of the person's beneficial interest under the said Deed of Trust and said Promissory Note, together with the money due and to become due thereunder, together with interest and all rights accrued or to accrue under said Deed of Trust [Findings of Fact and Conclusions of Law, Par. 20, p. 10; Clk. Tr. p. 167]. The Referee further found in the same Finding, Par. 20, and Appellants do not challenge such Finding, that neither the Bankrupt nor any of the said 16 persons intended by the execution of said Assignment that their proportionate share of the loan be satisfied, paid or discharged, but on the contrary, it was their intention that said loans continue in existence and become the property of the Bankrupt.

As stated in Appellants' Opening Brief at page 7, payments of said loan were made by Alan Realty Company, on behalf of the Bowers, during the period of time that the property was owned by the Bowers to

the individual lenders. The only other conflict in the construction concerning the evidence is whether or not Alan Realty Company was the agent of the owners, either Bowers or the Bankrupt, or the agent of the lenders. During this period of time the payments on the loan were made to the lenders. The Court specifically found as Appellee contended with reference to this conflict that Alan Realty Company was acting as the agent for and on behalf of Bowers and the Bankrupt during their respective ownership of ESC #3 [Findings of Fact and Conclusions of Law, Par. 25, p. 13; Clk. Tr. p. 170]. Thereafter, Alan Realty Company continued making the payments for the Bankrupt during the period that the Bankrupt was the owner. All fees were paid either by Bowers or by the Bankrupt. None of the fees, or any consideration, was paid by the Appellants.

Though the Court subsequently concluded that the promissory note and Deed of Trust made by Bowers in favor of Milton N. White, Trustee, was null and void and of no further force and effect [Conclusions of Law, Par. 4, p. 15], the Court being a Court of Equity, nevertheless found that it would be fair, just and equitable that the net proceeds of the sale of ESC #3 be divided 33/70ths to the Cross-Respondents and 37/70ths to Danning, as Trustee of the Bankrupt; the foregoing being based upon the pro rata percentages of each Group of the total \$210,000.00 loan.

The Trustee also filed a Petition for Review from that portion of the Order of the Referee dividing the

proceeds as hereinabove set forth on the basis that the Referee having found the Note and Deed of Trust to be null and void, that the Appellants were not entitled to any such division and were mere unsecured creditors. The Trustee, however, thereafter conceded to the District Court that should it agree that the Bankruptcy Court being a Court of Equity, could find and order that an equitable lien existed in favor of Appellants as to 33/70ths of the net proceeds to be derived from the sale, that the Trustee would accept such decision of the Reviewing Court, and accordingly, no further appeal has been filed by the Trustee from the decision of the District Court.

IV.

ISSUES PRESENTED.

There are only two issues involved in this matter and they are as follows:

(1) Whether or not the Referee committed error in holding that a fair, just and equitable division of the net proceeds of 33/70ths to the Cross-Respondents and 37/70ths to Curtis B. Danning, as Trustee, is correct.

(2) Having found that such Promissory Note and Deed of Trust are null and void, can the Referee nevertheless sitting as a Court of Equity hold that Appellants are entitled to an equitable lien upon an undivided 1/70th interest in ESC #3 for each \$3,000.00 and the corresponding interest in or to the net proceeds derived from the sale of ESC #3?

V.

ARGUMENT.

1. The Promissory Note and Deed of Trust Given as Security Therefor Is Null and Void and of No Force and Effect.

(A) Neither the Promissory Note nor the Deed of Trust Were Delivered by the Makers to the Beneficiary.

The uncontroverted testimony as heretofore set forth clearly indicates that "Milton White, Trustee", the purported payee and beneficiary of the Promissory Note and Trust Deed, never had possession of either of the documents. David Belinkoff testified that the documents were in the possession of Alan Realty Company, a copartnership, of which Belinkoff was a partner until after bankruptcy. This possession by Alan Realty Company, therefore, is of importance on this issue. An examination of Trustee Danning's Exhibits A, B and C, The Escrow Settlement Work Sheet, the Escrow Statement, and the Escrow Instructions [Clk. Tr. pp. 96, etc.] clearly indicate that Bowers, the makers of the Note and Deed of Trust, paid a real estate broker's commission to Alan Realty Company, and as set forth hereinbefore under Trustee's Statement of Facts, Alan Realty Company obviously was the agent of the Bowers. There is no evidence whatsoever that Alan Realty Company was the agent or representative of Appellants under the so-called Trust in which Milton White was the alleged Trustee.

Delivery is a requisite to the validity and operation of a Deed of Trust (C.C.P. 1933; *Miller v. Jansen*, 21 Cal. 2d 473; 132 P. 2d 801). The mere signing of a deed by the grantor and acknowledgment by the grantor are not sufficient to divert the grantor of title.

Delivery is essential. (*Miller v. Jansen, supra*, and other cases cited therein). Possession by the grantee gives rise to an inference that the instrument was duly recorded. But possession by the *grantor* has been informally held to make out a case of nondelivery, unless actual delivery be shown, and that the grantor's possession was merely for safekeeping or similar purpose (*Miller v. Jansen, supra*).

The burden of proof is on the Appellants in an action to foreclose to establish the existence of the Deed of Trust in Appellants' favor (*Siter v. Jewett*, 33 Cal. 92). Appellants have completely failed to meet this obligation for they have not established that the Deed of Trust and Promissory Note were delivered.

A very similar situation took place in *Nobel v. Learned* (153 Cal. 245; 94 Pac. 1047). One Lee executed an assignment of stock certificates to Learned, delivering the certificates to Noble. The Court held that the mere assignment without delivery to Learned did not vest title or any rights in Learned. In the instant case the Bowers signed a conveyance (Deed of Trust) and Promissory Note in favor of Milton White, but delivered it to Alan Realty. There is no showing that Alan Realty was White's agent or that Alan Realty's possession was White's possession. Following the *Noble* case *supra*, White got nothing.

Appellee does not quarrel with the authorities cited by Appellants such as *Butler v. Butler*, 188 Cal. App. 2d 228; 10 Cal. Rptr. 382, nor Section 3 of the Article on Brokers in 9 Cal. Jur. 2d excepting that the Appellee would like to point out it is his theory that the proof actually shows failure of delivery. Appellants concede that the presumption of delivery is re-

buttable and it is the position of the Appellee that not only has it been rebutted but that the proof clearly indicates that no delivery of any kind was made.

The question as to whether or not a broker may, under certain circumstances, act as the agent of both parties is not herein involved; nor is the fact that he received his fee from a particular person one of the issues. The evidence is clear that Bowers employed Alan Realty Company to obtain the funds for the loan, paid Alan Realty Company a commission for obtaining the loan, Alan Realty Company collected the funds and disbursed the loan payments to the Appellants and the other lenders. It is the uncontroverted evidence that two of the principals of Alan Realty Company were officers, stockholders and directors of the Bankrupt, and even after the conveyance to the Bankrupt, Western Growth Corporation, Alan Realty Company made payments to the lenders even before Western Growth, the Bankrupt, made the payments to Alan Realty Company, or, in effect, Alan Realty Company actually advanced the money for the owner, Western Growth, to the lenders before receiving the money [Rep. Tr. p. 106, lines 8-18]. It was the Bankrupt who obtained assignments of 16 of the lenders of their various interests. It is, therefore, without a question that Alan Realty Company, during the entire time that it held the Promissory Note and Deed of Trust, was the agent first, of Bowers, and second, of the Bankrupt, and was not the agent of the Appellants. Appellants concede in their Opening Brief commencing with Paragraph b on page 17 and thereafter on page 18, that it was Bowers who directed that the Deed of Trust be delivered to Alan Realty Company, and the Trustee

finds no fault with the cases cited by Appellants concerning agreement made by parties as to delivery of a deed to third parties; but nowhere do Appellants in their Brief point out to this Court testimony or agreement which the 31 lenders made whereby they directed that the Note and Deed of Trust be delivered at their instance and request to Alan Realty Company. The fact that the Deed of Trust was delivered to the Escrow Company by the makers does not constitute such an agreement because the Escrow Company merely retained the same as agent for all of the parties and then caused the same to be mailed by the County Recorder to Alan Realty Company.

(B) A Valid Trust in Which Appellants Were the Beneficiaries Never Existed.

Assuming *arguendo* that Milton White was the Trustee for the Appellants, still no trust was ever created.

The theory of Appellants is that Milton White held the payee's interest in the Promissory Note and the beneficiary's interest in the Deed of Trust as Trustee of a trust in which the Appellants were beneficiaries.

We are here talking about the alleged trust by which Milton White was the Trustee and the Appellants the beneficiaries, as distinguished from the alleged trust created under the Deed of Trust in which Milton White was the beneficiary and Wilshire Escrow Company, the Trustee.

The burden of proof of establishing a trust is on the party attempting to establish the trust (*Cohn v. Cohn*, 130 Cal. App. 349; 20 P. 2d 61). This party is Appellants.

What is the evidence in this regard? The trust *res* (the Note and Deed of Trust) were never delivered to Milton White and it never came into his possession (see above for discussion). The trust *res* was in the possession of Alan Realty, who were the brokers and agents of the trustor (Bowers). There is no trust agreement. Milton White, the alleged Trustee, never knew who the alleged beneficiaries were or their interest. There was no designation of beneficiaries. He received no instructions, never saw Exhibit 4, the instructions of the lenders, and he signed the Escrow Instructions at the request of Alan Realty Company.

To constitute a valid express trust, it is essential that there be (1) a trustee, (2) an estate conveyed to him, (3) a beneficiary, (4) a legal purpose, and (5) a legal term. (*Johnston Estate*, 47 Cal. 2d 265, 303 P. 2d 1; *Walkerly Estate*, 108 Cal. 627, 41 Pac. 772). Equity will in some cases make good the absence of a trustee, but if one of the other essentials are lacking the trust itself must fail (*Walkerly Estate*, 108 Cal. 627, 41 Pac. 772).

It is essential to the creation of an express trust that some estate or interest be actually conveyed or transferred to the Trustee (*Nichols v. Emery*, 109 Cal. 323, 41 Pac. 1089; *O'Neil v. Ross*, 98 Cal. App. 306, 277 Pac. 123). There being no delivery to White of the *res*, the conveyance or transfer was incomplete, and White got nothing (*Noble v. Leonard*, 153 Cal. 245; 94 Pac. 1047).

Further, there does not appear to be any evidence of who the beneficiaries of the trust were. The purported Trustee, White, testified he did not know who they were. Not one of the alleged beneficiaries came forward to testify to the fact he was a beneficiary.

Appellants, in their Opening Brief, beginning on page 18, lay great stress on the argument that Milton White acted as a dry or passive Trustee and as such took title to the Note and Trust Deed in their behalf and in behalf of all 31 lenders. Appellee does not agree with the conclusions of Appellants that Referee Champlin and/or Judge Thurmond Clarke failed to appreciate the nature of the trust because the Referee looked for a trust *res* and did not recognize that there had been created a dry or passive trust. Appellee does not find fault with the argument that under the laws of the State of California a valid, dry or passive trust may be created. Appellee, however, takes the position that under Civil Code Section 2220 of the State of California and *Engineering, etc. Corp. v. Longridge Investment Co.*, 153 Cal. App. 2d 404; 314 P. 2d 563, that no passive or dry trust was created because it was not created under the terms of any contract. In a dry trust the beneficiary is entitled to actual possession and enjoyment of the property and to dispose of it and call on the Trustee to execute such conveyance as he directs. In short, the beneficiary has absolute control over the beneficial interest. Together with the right to call for the legal title (*Ringrose v. Gleadall*, 17 Cal. App. 664; 121 Pac. 407). Let us assume for

the purpose of this discussion that a dry or passive trust was created. The Trustee, as the evidence clearly indicates, does not know who are the beneficiaries, or what is their interest. Thirty-one persons, the beneficiaries, have control over the beneficial interest and the right to call for the legal title. How does the purported Trustee, Mr. White, take instruction to call for such legal title, and assuming that he knows or is advised as to who they might be, does he take the instruction of one, or more, the majority in number or interest, or does it require all of the beneficiaries to call for the legal title. It is the position of the Appellee that Appellants must meet the burden to prove that a trust, whether dry or passive, was created and the legal purpose thereof. There was no conveyance of the trust *res*, no beneficiaries, and accordingly, it is the position of the Appellee that the trust must fail.

Appellee would, however, like to point out to this Court that it is Appellee's position that this was not a dry or passive trust because of the fact that under the evidence Milton White had certain duties. Appellants' Exhibit 4 (Dr. Zane's Escrow Instructions) indicates the money deposited by the 31 lenders was to be used on White's instructions. This would seem to indicate that if a trust was created, White had duties and was more than just a passive Trustee. The question is not whether or not the trust was passive or active, but the question is, was there a legal trust or not?

2. Are Appellants Entitled to an Aggregate Interest of 33/70 in ESC #3 and in the Net Proceeds From Any Sale Thereof, and Is the Appellee, Trustee in Bankruptcy, Entitled to the Remaining 37/70 Interest Therein?

Although it was the position of the Appellee before the District Court that the Referee having held the Promissory Note and Deed of Trust void, that Appellants were entitled to nothing above that allowed to general unsecured creditors. In the Memorandum of Points and Authorities filed by the Appellee with the Honorable District Court, Appellee concluded that if the District Court agreed with the ruling of the Referee in Bankruptcy, that Appellants were entitled to some recognition; that it would then be the position of the Appellee that the decision of Referee Champlin was proper and each of the Appellants is only entitled to that portion of the proceeds of any sale of the real property that his original loan bore to the entire loan.

The Referee found that it was fair, just and equitable that the net proceeds of the sale of ESC #3 be divided 33/70 to the Appellants and 37/70 to the Appellee, Trustee, and concluded that an equitable lien to the Appellants existed as to the proceeds of sale in such respective amounts [Findings of Fact, Par. 32, Conclusions of Law, Par. 7]. The parties stipulated that the original total loan amounted to \$210,000.00; was comprised of 70 units of \$3,000.00 each; that the Appellants' group represents 33 units totalling \$99,000.00, and that the balance of the lenders totalling \$111,000.00 assigned their respective interests in the Note and Deed of Trust to the Bankrupt herein. It was further stipulated that the Bankrupt acquired

title to the real property *subject to* all encumbrances of record [Pretrial Conference Order p. 4, lines 2-17; Clk. Tr. p. 95e].

Inasmuch as counsel for Appellants cited many cases involving an assumption of an obligation by a grantee as distinguished from the grantee acquiring real property subject to an encumbrance, the distinction becomes one of some importance.

Where property is mortgaged, the property itself is primarily liable for the debt (*Wenzel v. Schultz*, 100 Cal. 250, 34 Pac. 696). A grantee of the property is not personally liable unless he specifically assumes liability (*Bogart v. Porter Co.*, 193 Cal. 197, 223 Pac. 959; *Andrews v. Robertson*, 177 Cal. 434, 170 Pac. 1129). A conveyance merely subject to a mortgage imposes no personal liability for the mortgage debt on the grantee (*Andrews v. Robertson*, 177 Cal. 434, 170 Pac. 1129). Similarly, a purchaser of property subject to a trust deed is not ordinarily liable personally for the debt secured (*Wolfert v. Guadagno*, 130 Cal. App. 661, 20 P. 2d 360). To take advantage of an agreement to assume a mortgage, it is the mortgagee's duty to show affirmatively that the grantee made the agreement with the mortgagor (*Thomson v. Bettens*, 94 Cal. 82, 29 Pac. 336). There is no evidence of any assumption, only a stipulation and pretrial order that Western Growth acquired the property subject to the encumbrances, if any.

The beneficiaries' security interest in the real property was an undivided 1/70 interest for each \$3,000.00 loaned.

It has been stipulated by the parties that originally there were 31 persons who loaned 70 units of \$3,-

000.00 each for a total of \$210,000.00. About August, 1960 before a default in the repayment schedule, 16 of the 31 persons, in consideration of the assignment of such obligation and security interest to Western Growth, received from Western Growth a new unsecured obligation. As a result of these transactions either: (1) the 70 units of \$3,000.00 each are still outstanding and Western Growth is the owner of 37/70 undivided interests in the security and Appellants own the remaining 33/70 undivided interests therein; or (2) there in only 33/70 undivided interests in the security still outstanding and Appellants owned these.

Appellants' Exhibit 8 [the letter of David Belinkoff dated February 5, 1962; Clk. Tr. p. 128] was introduced and received by the court for the purpose of showing the security each of the alleged beneficiaries had in the real property, if they had any at all.

Exhibit 8 relied heavily upon by Appellants, designates that each of the alleged beneficiaries had a 1/70 undivided interest in the property for each \$3,000.00 loaned. This is Appellants' own exhibit; in the absence of other evidence, they are bound by it. Since Appellants represent 33 units, they would be entitled to a maximum of 33/70 undivided interest in the real property as security, and on sale of the property, they should get a maximum of 33/70 of the net proceeds of sale.

Further, if Appellants' contentions are correct, originally there were 70 units of \$3,000.00 each loaned to Bowers and a Deed of Trust given to secure this loan. If prior to the time that some of the lenders were divested of their interests there had been a foreclosure sale, each lender would have received 1/70 of the net sale price for each \$3,000.00 loaned.

Is there any reason to give the 15 remaining lenders (Appellants) more than 1/70 for each \$3,000.00 loaned? To do so would be to give them a windfall at the expense of the unsecured creditors of this bankruptcy estate. The Court would have to say that because the other 16 lenders were divested of their interests by transferring their interests to the Bankrupt, Appellants increased their bargained-for security interest from 1/70 for each \$3,000.00 loaned to 1/33 for each \$3,000.00 loaned, at the expense of unsecured creditors. The result would distort the original agreement and should not be allowed to come to pass.

There is uncontradicted evidence [Rep. Tr. pp. 90, 91] by both Ann Fostoff (a former employee of Western Growth and Alan Realty) and [Rep. Tr. pp. 107, 108] Belinkoff (a partner of Alan Realty and officer, director and stockholder of Western Growth) that when each of the 16 lenders received consideration for their share of the units they (the 16 Lenders) executed and delivered an Assignment of Deed of Trust and Promissory Note to Western Growth on a form similar to Danning's Exhibit E [Clk. Tr. p. 102]. This then shows an intention by these Lenders and by Western Growth that there be an assignment of these Lenders' rights to Western Growth; that there was not nor was it intended to be a discharge of the obligation and security. The question, then, is whether by operation of law the debt and security were discharged, so that Western Growth did not acquire any interest in the loan and security. It is Appellee, Danning's position that the debt did not become discharged and that the bankrupt estate owns and should participate in the proceeds of any sale of the security.

On the other hand, Appellants contend that the Bankrupt acquired the interests of the 16 original Lenders, a merger of title took place, and accordingly the security interest of the 16 Lenders merged into Western Growth's fee title. Appellants' attempt to use the merger doctrine against the Bankrupt cannot prevail.

In *Jameson v. Hayward*, 106 Cal. 682, 688 (39 Pac. 1078) the Court stated the rules as to when equity would act, as follows:

“ . . . [E]quity will prevent or permit a merger, as will best subserve the purpose of justice, and the actual and just intent of the parties. In other words, equity is not guided by rules of law as to merger. In the absence of an expression of intention, if the interests of the person in whom the several estates have united, as shown from all the circumstances, would be best subserved by keeping them separate, the intent so to do would ordinarily be implied.”

The Court need not determine what the results should be if the Bowers (the borrowers and principal and primary debtors) had paid the debt or had taken an assignment of the debt. The uncontroverted facts are that the Bowers did not pay the debt or take an assignment of the debt. Western Growth did.

As set forth above, it was stipulated in the Pretrial Conference Order that Western Growth acquired the property *subject* to the encumbrances [Par. 8, p. 4, lines 12 *et seq.* of the Pretrial Conference Order]. There is no evidence that in addition they assumed the encumbrance. Therefore, Western Growth is not and was not the primary or principal debtor. This distinc-

tion is of importance because in the citations of Appellants the persons who paid or took an assignment of the debt was either the (1) borrower or (2) had assumed the debt which led to an extinguishment of the debt.

Appellants cite *Dowds v. Spring*, 174 Cal. 412; 163 Pac. 351, in support of their contention that Western Growth's taking of the assignment of the debt and security extinguished the debt and security. In that case, at the time of payment by the *assuming* grantee, William A. Kjellman, and his taking of an assignment of the debt, the grantee had already divested himself of the fee by a conveyance to another, and therefore, he did not own an interest in the real property. Since he did not own an interest in the property, the rule of *Jameson v. Hayward*, 106 Cal. 682; 39 Pac. 1078, did not apply for Kjellman would not benefit by preventing an extinguishment. In the instant case at the time of the assignment Western Growth owned the fee and had not assumed; therefore, the case is clearly distinguishable on two grounds. Kjellman was the primary obligor, Western Growth was not. Kjellman assumed the debt, Western Growth did not.

In *Liddle v. Lechman*, 114 Colo. 189, 163 P. 2d 802, a *Colorado* case, the Court found that the *assuming* grantee *intended* to extinguish the debt and security in that in obtaining a subsequent loan on the property, the subsequent lender was advised the money would be used to pay off the prior loan and the subsequent lender would get a security interest free and clear of all prior encumbrances. Therefore, in the *Liddle* case there was an actual intent to extinguish. In the instant case the uncontroverted facts are that Western Growth did not

intend to extinguish the loan and security, but on the contrary received an assignment of each of lender's interest. But even if the assignment does not indicate such intent, the rule of *Jameson v. Hayward*, 106 Cal. 682, 39 Pac. 1078, would control. In the absence of evidence of intent, it being clear that Western Growth's interests would be best served by allowing the obligation and security to remain alive, the Court should not declare a merger. Also, the *Liddle* case indicates there was evidence of an assumption.

In *Malinoski v. Mekody*, 48 N.Y.S. 2d 940, a trial court case and one relied upon by Appellants, Malinoski (the owner) gave a bond and security interest to one Bucaniec covering two parcels of land. Later Bucaniec assigned the bond to Bronner and Bronner immediately assigned 12/40 of the bond back to Bucaniec and 28/40 to Kuehnle. Years later Malinoski (the owner) deeded the land to Mekody, who assumed the bond and mortgage. Thereafter, Bucaniec signed and recorded a release of his security interest in part of the real property. He also assigned his interest in the bond and remaining security to Malinoski, the former owner.

In a foreclosure suit by Kuehnle against Mekody (as assuming fee owner) and Malinoski as the *original* mortgagor, the Court held that as Malinoski was the original mortgagor, any interest he still claimed in the property was subject to his original mortgage. This is a great distinction as in the instant case, Western Growth is not the original mortgagor and there is no contract of assumption for the benefit of the lenders; therefore, *Malinoski* does not apply. Further, in *Malinoski* there does not appear to be any intent that each por-

tion of the loan be secured by an undivided interest. The Malinoski loan was from one person and did not contain release clauses. In the Bowers Note and Deed of Trust there is an intent manifested that for each \$3,000.00 paid, 1/70 of the security be released. This case differs from Malinoski considerably and it should not control.

Whatever the law of Colorado and New York may be, the law of California clearly gives Western Growth an interest in the loan. In *Matzen v. Schaeffer*, 65 Cal. 81, 3 Pac. 92, the appellant, Matzen, purchased land from an owner thereof subject to a mortgage. Prior to the sale, but after the mortgage was placed on the property, Schaeffer obtained a judgment lien on the property. At the time of the purchase Matzen paid off the mortgage and the mortgagee satisfied it. Schaeffer executed on the property and obtained a Sheriff's deed. In this suit to quiet title the Court said, at Page 82:

"This presents a case in which the interests of the appellant required that the lien of the mortgage which she paid off should be kept alive. Her interests can only be fully protected by regarding the transaction in which she paid off the mortgage as an assignment of it to her, and the lien as being kept alive for her security and benefit. 'In general, *when any person having a subsequent interest in the premises, and who is therefore entitled to redeem, for the purpose of protecting such interest, and who is not the principal debtor primarily and absolutely liable for the mortgage debt, pays off the mortgage, he hereby becomes an equitable assignee thereof, and may keep alive and enforce*

the lien so far as may be necessary in equity for his own benefit; he is subrogated to the rights of the mortgagee to the extent necessary for his own equitable protection.' (Italics added for emphasis) (3 Pomeroy's Eq. Juris. §1212.) And this equitable result follows, 'even though a receipt was given speaking of the mortgage debt as being fully paid, and sometimes even though the mortgage itself was actually discharged and satisfied of record.' (3 Pomeroy's Eq. Juris. §1212.)"

The Court then presumed an assignment even though the debt was discharged, and preserved the mortgage and obligation for Matzen, giving her a superior right to Schaeffer.

In *Barnes v. Cady*, 232 Fed. 318 (6th Cir. 1916), the Circuit Court of Appeals, Sixth Circuit, followed the *Matzen* case *supra*, and held that a grantee who paid off the first mortgage on the property was subrogated to the rights of the first mortgage and was to be considered an equitable assignee of the holder of the first mortgage as against a subsequent encumbrancer, notwithstanding a satisfaction of the mortgage and debt secured thereby.

Both the *Matzen* and *Barnes* cases, the letter in Federal Court, support Appellee Danning's position and should be followed: that is, there was no merger of title when Western Growth took an assignment of 37/70 of the loan.

Appellee takes great exception to the statement made in Appellants' Opening Brief on Page 26 concerning the citation of *Wilson v. McLaughlin*, 20 Cal. App. 2d 608; 67 P. 2d 710. Counsel omitted a paragraph

from the case which belongs between the two paragraphs cited on Page 27. Appellee respectfully calls this Court's attention to the paragraph which belongs in between these two paragraphs, which states the position of the Appellee and reads as follows:

“The principle of these equitable rules has no application to the facts in evidence. The deed to Mrs. Nelson recited as follows: ‘It is expressly agreed that as a consideration for the within conveyance, the Grantee herein *expressly assumes and agrees to pay* and discharge a mortgage in the sum of \$30,000.00, now against the property, together with accrued interest thereon, as well as all taxes and special assessments levied or to be levied against the above described property.’ *Thus she became the principal debtor* and her grantor a surety. (*Williams v. Naftzger*, 103 Cal. 438 [38 Pac. 411]; *Tulare County Bank v. Madden*, 109 Cal. 312 [49 Pac. 1092]; *Small v. C. R. Rogers, Productions*, 11 Cal. App. (2d) 191 [53 Pac. (2d) 774], and cases there cited.)” (Emphasis added).

The foregoing paragraph in *Wilson v. McLaughlin* again points out the substantial difference between “subect to” and “assumption” of the debt. The ruling made by the Court in *Wilson v. McLaughlin* is because of the fact that Mrs. Nelson, the grantee therein “*expressly assumes and agrees to pay and discharge a mortgage*”, and it is this position that the Appellants fail to recognize. The Bankrupt under the facts, the testimony, the stipulation and pretrial order did not in any manner assume the obligation of the Note and Deed of Trust.

If as Appellants contend, but have not proved, Western Growth paid off the obligations of 37/70 of the original lenders, rather than taking an assignment of their obligation, then the Court should declare the transaction was as if a reconveyance of 37/70 undivided interest in the real property took place so that 37/70 undivided interest is free and clear.

The Deed of Trust contained the following release clause:

“It is understood and agreed by and between the Trustor and Beneficiary, as follows: The land described in this Deed of Trust is to be subdivided into 70 lots. So long as the Trustor shall not be in default in any of the covenants contained herein or in the payments due on the Promissory Note secured hereby, a partial reconveyance may be had and will be given from the lien or charge hereof of any one or more of the subdivision lots hereinbefore described, upon payment of an amount to apply on the principal of said Note based on the rate of \$3,000.00 per lot for each lot so reconveyed, plus accrued interest and any prepayment penalty as called for in said Note.”

Admittedly, the provision states that the property is to be subdivided into 70 lots, but there is no promise on anyone's part to do so. The condition of the release clause is:

“So long as the trustor shall not be in default in any of the covenants contained herein or in the payments due on the Promissory Note secured hereby . . .”

It has been stipulated that there was no such default at the time of the payment by or taking of an assignment by Western Growth of 37/70 of the obligation and security. Therefore, the condition was met. There was no condition regarding subdividing the property. Since 37 units of \$3,000.00 were at least paid off, Western Growth should get the benefit of the bargain and get a release of 37/70 of the property. This is fair, just and equitable and as a result, Appellants still have a security interest in 33/70 of the property, which is all they bargained for. The fact that their interest is undivided, rather than divided, does not prejudice them as the Trustee, Danning, intends to sell once title to the property is determined. It must be apparent to this Honorable Court that such selling price will not equal the loan amount of \$210,000.00 plus delinquent taxes, etc., or this entire proceeding would be moot.

On page 32, Paragraph 3 of their Opening Brief, Appellants take the position that the Bankrupt assumed the Note and Deed of Trust, but even assuming *arguendo* that the purchase was made by the Bankrupt subject to, it is their contention that the law is well settled that where the "subject-to grantee" takes an assignment of the mortgage, the debt secured by the mortgage is held to be extinguished.

The question of whether or not the Bankrupt assumed the Note and Deed of Trust or took the same subject to the Note and Deed of Trust has been discussed in full and no further comment will be made hereat concerning this question.

Again, Appellants have failed to set forth in their Opening Brief the entire citation cited on Page 33 as

95 A.L.R. 89, 107. So that this Court will have the benefit of the entire citation, the omitted portion is set forth as follows, and there is italicized that portion which Appellants failed to include in their Memorandum:

“As a general rule, where a purchaser of land subject to a mortgage takes an assignment of the mortgage, the debt secured by the mortgage is extinguished, and *personal liability therefor cannot be enforced.*”

All of the cases cited under this annotation are cases which the mortgagee attempted to obtain a personal judgment against the maker or accommodation maker on the theory that the land was the primary fund for the payment of the debt and the Courts refused to render a personal judgment or deficiency judgment in each of these cases. And again, in the citation of Appellants in 37 Am. Jur. Mortgages, Section 1324, the entire Section refers to *the enforcement of personal liability*. Further, the next sentence following the citation of Appellants and omitted, reads as follows:

“Ordinarily, however, the prevailing rule is that the question of whether there is an extinguishment of the *personal* liability for the mortgaged debt on the acquisition of the mortgage and the mortgage debt by grantee of the mortgaged premises is one of intention.”

From the foregoing, it is readily apparent that no personal liability for the mortgaged debt could be recovered against the Bankrupt because it was not intended nor is there any evidence that the mortgagor would have any personal liability and if the mortgagor

(Bowers) could have no personal liability it is apparent that the Bankrupt had none either.

The equitable prevention of merger doctrine is applicable in this case. There is no doubt that a Court of Equity can prevent a merger and this doctrine is applicable here, and in response to Appellants' Point 4 in their Opening Brief, Page 35, it is sufficient merely to point out, through their own Brief, that this doctrine is available to prevent other persons to obtain a windfall from the owner's payment. (*Osborne on Mortgages*, p. 773).

The facts are uncontroverted. Appellants each received, at best, a $1/70$ undivided interest in the real property as security for each multiple of \$3,000.00 loan [Ex. 8]. They were of the opinion that each of them was secured and that the value of the land was equal to or in excess of such loan. They now request this Court to give them all of the land, eliminating $37/70$, or in other words, for each multiple of \$3,000.00 a $1/33$ interest instead of what they bargained for, a $1/70$ interest. This is reaping a windfall for them at the expense of the other $37/70$. This is more than they bargained for and is at the expense of the unsecured creditors. The Pretrial Order provides approximately that \$500,000.00 of secured notes were exchanged for non-secured notes of the Bankrupt. Are the holders of these notes not entitled to some consideration? In Appellants' Conclusion, they refer to a "swap" and refer that the unsecured creditors of the estate were aided by such "swap". On Page 4, Lines 18-22 of the Pretrial Conference Order [Clk. Tr. p. 95e] the parties admit that the "swap" was for unsecured notes of the Bankrupt, or a substitution of one

obligation for another. There is no evidence that these new obligations were paid, and as a matter of fact, the same are unpaid. Are not these creditors who “swapped” in a worse position for the reason that they do not now have any secured claim and have to participate with all of the other unsecured creditors whose claims are in the millions?

The cases cited by Appellants under this point have been fully discussed in this Reply Brief and bear no further discussion.

Conclusion.

The Referee in Bankruptcy was more than fair with the Appellants. He has found that the Note and Deed of Trust were null and void and that no trust is created. Although it is the opinion of the Appellee that the Appellants are mere unsecured creditors, the Court below found that an equitable lien existed in favor of Appellants and awarded to them 33/70 of the net proceeds to be derived from the sale of ESC #3. Appellee will accept such decision by this Reviewing Court.

Appellee contends that the Appellants have failed to show that the Referee's decision was clearly erroneous and submits that the Order of the United States District Court of February 10, 1967, affirming the decision of the Referee should be affirmed.

Respectfully submitted,

BUCHALTER, NEMER, FIELDS &
SAVITCH,

By IRWIN R. BUCHALTER,
*Attorneys for Appellee, Curtis B.
Danning, Trustee in Bankruptcy.*

Certificate.

I certify that, in connection with the preparation of this Brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Brief is in full compliance with those Rules.

IRWIN R. BUCHALTER

APPENDIX A.

<u>Exhibits</u>	<u>Identified</u>	<u>In Evidence</u>
Crane Ex. 1 (Promissory Note)	24	Received p. 25
Crane Ex. 2 (Trust Deed)	26	Received p. 26
Crane Ex. 3 (Bower-White Escrow Instructions)	28	Received p. 28
Crane Ex. 4 (Short Form Escrow Instructions)	28	Received p. 28
Crane Ex. 6 (Application of Trustee to Sell)	31	Rejected p. 32
Crane Ex. 8 (Letter of David Belinkoff dated February 5, 1962)	34	Received p. 35
Hanning's Ex. A (Wilshire Escrow Company document entitled "Escrow Settlement" Escrow No. 34757)	43	Received p. 43
Hanning's Ex. B (Wilshire Escrow Company document entitled "Escrow Statement" of James A. Bower dated September 10, 1959)	43	Received p. 43
Hanning's Ex. C (Wilshire Escrow Company document entitled "Escrow Instructions" dated August 31, 1959)	43	Received p. 43
Hanning's Ex. D (Letter dated July 1, 1960 from Ted Harris)	43	Rejected p. 49
Hanning's Ex. E (Form of Assignment of Deed of Trust)	88	Received p. 91
Crane Ex. 1 (Alan Realty Co. Accounting)	226-27	Received p. 227
Crane Ex. 2 (August 13, 1959 letter)	246	Received p. 247
Crane Ex. 3 (Bower Sale Documents)	278	Received p. 280
Crane Ex. 4 (Settlement Agreements 10/21/66)	281	Received p. 281
Crane Ex. 5 (Bower Purchase Escrow Documents)	281	Received p. 282
Hanning's Ex. A (Claim for Taxes)	287	Received p. 287

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In the Matter of

WESTERN GROWTH CORPORATION,
Bankrupt.

STEPHEN CRANE, III,

Applicant and Appellant,
vs.

CURTIS B. DANNING, etc.,

Respondent and Appellee

FILED

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WM. B. LUCK, CLERK

CURTIS B. DANNING, etc.,

Cross-Applicant,
vs.

LOUIS BENVENISTE, et al.,

Cross-Respondents and Appellants.

REPLY BRIEF OF APPELLANTS

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

GREENBERG & GLUSKER and
RICHARD H. FLOUM
9601 Wilshire Boulevard
Suite 544
Beverly Hills, California 90210

Attorneys for Appellants

DEC 27 1967

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In the Matter of

WESTERN GROWTH CORPORATION,

Bankrupt.

STEPHEN CRANE, III,

Applicant and Appellant,

vs.

CURTIS B. DANNING, etc.,

Respondent and Appellee

CURTIS B. DANNING, etc.,

Cross-Applicant,

vs.

LOUIS BENVENISTE, et al.,

Cross-Respondents and Appellants.

REPLY BRIEF OF APPELLANTS

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

GREENBERG & GLUSKER and
RICHARD H. FLOUM
9601 Wilshire Boulevard
Suite 544
Beverly Hills, California 90210

Attorneys for Appellants

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REPLY BRIEF OF APPELLANTS

I

APPELLEE'S MISSTATEMENT OF RECORD

A. "Subject-to" Issue.

Appellee, clearly recognizing the force of appellants' authorities on the issue of merger, attempts to avoid same by claiming that here the bankrupt purchased Escondido No. 3

subject to the Bower \$210,000 deed of trust rather than, as argued by appellants (Opening Brief, pp. 8-11), expressly assuming same.

Thus, he argues:

"There is no evidence that in addition they [Western Growth] assumed the encumbrance. Therefore, Western Growth is not and was not the primary or principal debtor. This distinction is of importance because in the citations of appellants, the person who paid or took an assignment of the debt was either the (1) borrower, or (2) had assumed the debt which led to an extinguishment of the debt." (Appellee's Brief, pp. 23-24, emphasis supplied)

And, again, in attempting to distinguish the key California case of Wilson v. McLaughlin, 20 Cal. App. 2d 608, 67 P. 2d 710, the appellee argues:

"The foregoing paragraph in Wilson v. McLaughlin again points out the substantial difference between 'subject to' and 'assumption' of the debt." (Appellee's Brief, p. 28, emphasis supplied)

It is thus readily apparent that even appellee concedes that if the bankrupt corporation expressly assumed the obligation on the subject note and deed of trust, the doctrine of merger is applicable and consequently the bankrupt cannot assert the interests of the 16 of the original 31 investors against the remainder thereof.

Appellee obviously recognizes that if the issue is properly decided on its merits, the determination must be that the subject deed of trust was assumed by the bankrupt -- thus he nowhere disputes the analysis of this question contained in Appellants' Opening Brief, pp. 8-10. Therefore, he is forced to argue that the Pretrial Conference Order, Paragraph III-8, bars appellants from even raising what appears to him to be the pivotal and determinative question in this lawsuit.

In so arguing, appellee is guilty, although no doubt inadvertently, of a flagrant misstatement of the state of the record before this Court on this issue.

Thus, he completely ignores the fact that Referee Champlin specifically ordered the case re-opened for the taking of additional testimony on certain issues, including:

"

4. Whether or not when Western Growth Corporation, the bankrupt, acquired the subject real property, it assumed the obligation to pay off the encumbrance thereon or took subject to said encumbrance." (C. T. 133)

Consequently the "subject-to" issue was fully litigated and the determination thereof subject to review by this Court.

B. Payments on the Encumbrance.

Appellee, apparently also recognizing that payments made by Bower on the subject note and deed of trust are themselves strong evidence of Bower's intent to be bound by the subject deed of trust, further misstates the record by blandly declaring that:

"As stated in Appellants' Opening Brief at page 7, payments of said loan were made by Alan Realty Company, on behalf of the Bowers, during the period of time that the property was owned by the Bowers to the individual lenders."

(Appellee's Brief, pp. 9-10)

In fact, Appellant's Opening Brief states at p. 7 that "Alan Realty Company . . . received payment [on the note and trust deed] from the Bowers and subsequently from the bankrupt (after it acquired the property) and it handled the accounting and depositing the moneys collected for many of the original 31 investors." (emphasis supplied) A check of the record citations and exhibits relied on in Appellants' Brief at page 7 will demonstrate the accuracy of this statement and the inaccuracy of appellee's.

II

THE SUBJECT NOTE AND DEED OF TRUST ARE VALID AND IN FULL FORCE AND EFFECT.

A. The Requisite Delivery Has Been Made Out in This Case.

Appellee completely ignores in his brief the fact that we deal in this case with a recorded deed of trust and the concomitant rules that (1) such recordation at the request of the maker thereof constitutes prima facie evidence of delivery with intent presently to convey or create the interest set forth therein and (2) that "recordation coupled with manual delivery raises a strong presumption, which can be overthrown only by very clear proof." 2 Witkin, Summary of California Law, Real Property §55. Here, we have both the recordation of the subject deed of trust and its delivery pursuant to its express terms to Alan Realty Company. It is thus totally beside the point whether Alan Realty Company was, as appellee contends, an exclusive agent for Bower or, as appellants contend, a dual agent acting for both Bower and the 31 investors. The controlling point is that the strong presumption of requisite delivery which arose by reason of the recordation of the deed of trust and its delivery to Alan Realty Company pursuant to the instructions of the Bowers, the makers thereof, has not been overcome by appellee.

Appellee relies on Miller v. Jansen, 21 Cal. 2d 473,

132 P.2d 801, and Noble v. Learned, 153 Cal. 245, 94 Pac. 1047, which he describes as involving a "very similar situation." (Appellee's Brief, p. 13). What he neglects to inform the court is that in neither of these cases was there a recorded instrument giving rise to the presumption of delivery. Moreover, Noble v. Learned, the case which appellee contends involves a very similar situation, is clearly distinguishable for another reason: there, there was specific testimony by the person to whom the stock had been delivered, that the assignor thereof did not intend to effect a present transfer thereof (See 153 Cal. at 249).

B. Validity of Dry or Passive Trust.

Appellee concedes the correctness of appellants' position "that under the laws of the State of California a valid dry or passive trust may be created." (Appellee's Brief, p. 17) However, appellee argues that no such trust was created in the instant case, because Mr. White, the trustee, did not know who the beneficiaries were and, furthermore, because he had certain duties in respect to the deposit of the 31 investors' money into the escrow with the Bowers (Appellee's Brief, p. 18).

Here again, appellee misconceives the issue: the issue is not what White's duties were, vis-a-vis the escrow, but rather what his duties were vis-a-vis the note and deed of trust. In that regard White specifically testified (See Appellants' Opening Brief, pp. 6-7) that his name was on the subject note and deed of trust simply to facilitate the loan transaction by using one person



in behalf of and in the place of 31 investors who would hold title for them until the subdivision occurred. Therefore, obviously at any time any one of the 31 investors wished to have Mr. White removed, they could have done so -- hence, a classic dry or passive trust.

Finally, even if it were assumed *arguendo* that the subject dry or passive trust must fail for the reasons argued by appellee, or any other reason, this still would not help him since, under well-settled law, the trust res (the subject note and deed of trust) would automatically pass to the intended beneficiaries thereof who paid value therefor. So then these instruments were always capable of enforcement in such an eventuality by the 31 investors. (See 3 Scott on Trusts (1939 ed.) §412; 54 Am. Jur. Trusts §196, at n. 14, and 48 Cal. Jur. 2d Trusts §66, at notes 8 and 9.)

Hence, it is clear that the subject note and deed of trust were and are valid and subsisting instruments.

III

APPELLEE IS NOT ENTITLED TO ASSERT
THE CLAIMS OF THE 16 ORIGINAL INVES-
TORS WHO ASSIGNED THEIR INTEREST IN
THE NOTE AND DEED OF TRUST TO THE
BANKRUPT IN 1960.

Appellants spent the major portion of their Opening Brief in arguing the efficacy of the above statement (See Appellants' Opening Brief, pp. 21-39). An analysis of appellee's response shows that he has been unable to come up with any authority contrary to

appellants' controlling authority and hence was forced to rely on the totally improper position that appellants have conceded that the bankrupt took the Escondido No. 3 property subject to the \$210,000 Bower trust deed, rather than assuming same. But as demonstrated in the Opening Brief of Appellants (pp. 8-11), the finding or conclusion of law of Referee Champlin in this regard is clearly erroneous and is not binding on this Court which, under the authorities cited in Appellants' Opening Brief (p. 10, footnote 1), must construe and interpret a written instrument de novo. Since the bankrupt then was clearly an assuming grantee, all of the authorities relied upon by appellants (which have in no way been weakened or even disputed by appellee's) are controlling and require the determination sought by appellants herein. The plain fact of the matter is that, as demonstrated in Appellants' Opening Brief (pp. 35-39), the equitable prevention of merger doctrine has never been applied by any court in the entire land to permit a landowner to dilute another's lien of like priority to that acquired by the landowner, which would be the precise effect of the application of such a rule in the instant case. The Matzen and Jameson cases relied on by the appellee are clearly distinguishable (See Appellants' Opening Brief, p. 38), while the controlling California cases, Dodds v. Spring, 174 Cal. 412, 163 Pac. 351, and Wilson v. McLaughlin, 20 Cal. App. 2d 608, 67 P. 2d 710 (digested in Appellants' Opening Brief, pp. 26-28) require an adoption by this Court of appellants' view.

Finally, it must be noted that appellee has failed to

demonstrate -- although he asserts the fact to be true -- that if indeed the bankrupt purchased Escondido No. 3 subject to the Bower deed of trust, the result on merger would be any different. To the contrary, all the authorities appellants have found (Opening Brief, pp. 32-35) also uniformly support the rule contended for by them herein.

IV

CONCLUSION

More than 8 years after appellants, or those through whom they claim, made their investment, they are still fighting to recover some of their money, which can only be realized from a sale of Escondido No. 3. The Bower purchase escrow (2d Crane Exhibit 5) shows that the total purchase price for this land in 1959 was \$70,000, \$67,500 of which came from the escrow into which the \$210,000 contributed by the 31 investors had gone. It is thus obvious that appellants herein can never hope to recover all of their money back from the liquidation of this property. To permit appellee to take more than one-half of the net proceeds which will be derived from the sale of Escondido No. 3 away from appellants, as Referee Champlin and Judge Clarke did, would be so unfair and so contrary to all existing law, that we cannot believe the Court will so hold.

The opinion of the District Court affirming Referee Champlin's order should be reversed and the lower court instructed to

enter an order in favor of appellants, permitting them to foreclose their deed of trust on Escondido No. 3 and to retain the net proceeds thereof, up to the sum of \$84,452.36 plus interest thereon, which is the amount admittedly owed to them.

Respectfully submitted,

GREENBERG & GLUSKER and
RICHARD H. FLOUM

By: RICHARD H. FLOUM

Attorneys for Appellants.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/

RICHARD H. FLOUM

United States
COURT OF APPEALS
for the Ninth Circuit

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v.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S OPENING BRIEF

*This is an Appeal from the Judgment and Conviction
of the United States District Court for the
Western District of Washington
Northern Division*

THE HONORABLE WILLIAM J. LINDBERG
Judge Presiding

FILED

SEP 6 1967

JULIAN HERNDON, JR.
HERNDON & WHITNEY

Suite 300 Helm Building
Portland, Oregon

Of Attorneys for Appellant

WM. B. LUCK, CLERK

SEP 11 1967

STATEMENT OF JURISDICTION

The Court of Appeals for the Ninth Circuit has jurisdiction of the appeal in this cause by virtue of Section 1292 (a) (1) of Title 28 United States Code, and/or Section 110 of Title 29 United States Code.

Russell M. Baker
OF: BAKER, JORDAN & FOREMAN
1610 CORNER PETROLEUM BLDG.
DALLAS, TEXAS 75201

Attorneys for Appellants

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion the foregoing brief is in full compliance with those rules

Russell M. Baker
—

OF: BAKER, JORDAN & FOREMAN
1610 Tower Petroleum Bldg.
Dallas, Texas 75201

Attorneys for Appellants

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STATEMENT OF THE CASE

Defendant was charged in a six count indictment, two counts each of violation 21 U.S.C. 174, 26 U.S.C. 4704 (a) and 26 U.S.C. 4705 (a), one count each on or about March 21, 1966 and one count each on or about April 11, 1966; was duly arraigned and en-

tered pleas of not guilty to each count. Trial was set for January 4, 1967 and commenced on that date. A verdict of guilty was returned by the jury on each count of the indictment on January 4, 1967, and on January 27, 1967, judgment and sentence was pronounced and imposed on Counts I, II, III, IV, V, and VI. Defendant appealed from the judgment and sentence rendered.

STATEMENT OF FACTS

First witness produced by the Government was Joseph Gordon, a King County Deputy Sheriff and testified he was on loan to the Narcotics Division from the Sheriff's Office (Tr. 42-43) and who was at the time of trial a Federal Narcotics Agent (Tr. 42-43). That he first met Jackson Morgan in an apartment in Seattle (Tr. 44). That he received a telephone call March 21, 1966 from Jackson Morgan (Tr. 45) and that he would be in Seattle in about 3 hours. He called Agent Ferro and Agent Ferro and Agent Parrish came to his home (Tr. 48). Agent Ferro gave Agent Gordon \$700.00 in advance funds (Tr. 48) and that later Gordon received a call from Jackson Morgan who told him to meet him at the Union 76 station (Tr. 49). Gordon went to the station and Jackson Morgan got in his car (Tr. 50) and Morgan asked him if he wanted two and Gordon told him to give him two pieces (Tr. 50). Morgan took a rubber container from his pocket and handed it to Gordon, who handed Morgan \$700.00.

The material was delivered to the United States Chemist (Tr. 59).

On April 11, 1966, Gordon received a call from Morgan (Tr. 59) stating that he had two for him and he left a number for Gordon to call him. Gordon called Agent Ferro and got \$350 in advance funds from him (Tr. 62). Gordon called Morgan back (Tr. 62) and said that he only had \$350 and Morgan asked if he had a scale so that he could split it. Deputy Gordon stated that he did not have and gave Morgan a phone number, which was the Bureau of Narcotics under cover number, to call him when he was ready (Tr. 62). Later, Gordon got a call from Morgan, who said he was ready and that he was to meet him in the same place he had met him before (Tr. 63). That he got in the vehicle of Morgan and that there was another rubber container on the seat and that he picked it up and gave him \$350 (Tr. 64). That he asked Morgan if he could adulterate it and that Morgan said he could add two spoonfulls if he wanted to ruin his customers (Tr. 64). The witness was allowed to testify over objection that Exhibit 2 contained no revenue stamps (Tr. 65), the same witness was allowed to testify that Exhibit 1 had no revenue stamps, over objection, that the Exhibit spoke for itself.

Agent Ferro testified that he saw Jackson Morgan enter the car of Agent Gordon (Tr. 81) and that Gordon gave Ferro a rubber cundrum containing a powdery substance (Tr. 83), Exhibit 1, and that he

delivered Exhibit 1 to the chemist (Tr. 85). That Agent Gordon delivered to him Exhibit 2 (Tr. 89).

The Court refused to allow the defendant to cross-examine Agent Ferro about a Harvey Edwards, a government informant, who according to the state's testimony in the case, introduced Gordon to a man named Ely, who in turn introduced the defendant to Gordon. Harvey Edwards having been a narcotics informant working with the bureau, who was under a similar charge. The defendant having contended in its opening statement, that the narcotics that were recovered by the government were obtained through Harvey Edwards. An offer of proof was made and rejected (Tr. 94-99).

The chemist testified that heroin hydrochloride is manufactured from morphine and that morphine is extracted from opium poppies (Tr. 117-118). That the poppies grow in the United States and that it is a fairly simple operation to extract the morphine and to manufacture the heroin from the poppies that grow in the United States and that in examining the material he could not determine if it was made in the United States (Tr. 119). The poppies grow in a temperate climate and they grow in the United States. That samples had been submitted from various parts of the United States to him and that they grow in Florida, Texas, California and parts of New Mexico and Arizona.

The Deputy United States Attorney, in his closing argument (Tr. 141) allowed that the poppies could

have been grown in the United States and the heroin could have been produced in the United States, but that the jury still had a duty to find the defendant guilty of knowing that they had been imported illegally into the United States because of presumption of law. This, whether or not they had been imported legally, or not (Tr. 141-142).

The Defense objected to failure to give requested Instruction No. 2, and also objected to the instruction as to the presumptions.

SPECIFICATION OF ERRORS

1. The court erred in limiting cross-examination of Agent Ferro concerning Harvey Edwards and in denying the introduction into evidence of information concerning Harvey Edwards, which was presented by defendant's offer of proof (Tr. 93-99).

2. The court erred in restricting cross-examination of Agent Gordon about Harvey Edwards (Tr. 69-74).

3. The court erred in denying defendant's motion for judgment of acquittal as to Counts I, II, III & IV (Tr. 122-124).

4. The court erred in instructing the jury that possession of narcotic drugs by the defendant was sufficient to raise a presumption that the narcotic drugs had been illegally imported into the United States and that the defendant knew that it had been illegally imported to the United State. And, by in-

structing the jury that a presumption is raised by possession of narcotics not bearing a revenue stamp that the narcotics did not come from the original stamped envelope (Tr. 166-169, 180).

5. The court erred in failing to give defendant's requested Instruction No. 2 and in giving the same in a modified form (Tr. 180).

SPECIFICATION OF ERROR NO. 1

The court erred in limiting cross-examination of Agent Ferro concerning Harvey Edwards and in denying the introduction into evidence of information concerning Harvey Edwards, which was presented by defendant's offer of proof wherein the following occurred (Tr. 93-99):

"Q. Now, do you know Edward—Harvey Edwards?

A. Yes, sir.

Q. And was he employed by the Narcotics Bureau?

MR. SWOFFORD: Objection, your Honor. I don't think there has been any testimony.

THE COURT: I will sustain the objection.

MR. HERNDON: Your Honor, we will make this witness our witness for this purpose.

THE COURT: All right.

By Mr. Herndon:

Q. (Continuing) Now, this Harvey Edwards, he is a narcotic user, is he not?

MR. SWOFFORD: Objection, your Honor, for the same reason.

THE COURT: Well, it may be—I will overrule the objection at this time.

By Mr. Herndon:

Q. (Continuing) He is an addict, isn't he?

A. Yes, sir, he was an addict.

Q. And at the time of the case you had charges pending against him, didn't you?

A. No, sir.

Q. Had they been disposed of?

A. Yes, sir.

Q. He had been charged, is that right?

A. A complaint was filed against him.

Q. And for what?

A. For possession of narcotics.

Q. And that case was dismissed?

A. It was dismissed for insufficient evidence.

Q. I see: and so then he went to work for you after it was dismissed for insufficient evidence?

MR. SWOFFORD: Objection, your Honor.

THE COURT: Well, you will have to make a showing of what you expect to prove here.

MR. HERNDON: Well, your Honor, I outlined in my opening statement what we expected to prove.

THE COURT: I know but the connection here is - -

MR. HERNDON: (Interposing) Your Honor, if I may go a little further, of course, this is within the knowledge of these agents. I am somewhat familiar with some of the background. I think that we can show that, through this witness I am hopeful we will be able to show, through this witness, that Harvey Edwards is the party that the government employed and paid funds to, out of whatever funds they pay

him, and used him to introduce them to the Defendant in this case, and it boils down to a question of the situation — it gets down to the word of the detective and the narcotics agents.

THE COURT: Introduced who to the Defendant?

MR. HERNDON: I believe that Harvey Edwards introduced the deputy sheriff.

THE COURT: Well, of course, you have to ask the deputy sheriff that question.

MR. SWOFFORD: There has already been testimony.

THE COURT: I think he said he had nothing to do with this case. That is my recollection.

MR. SWOFFORD: Right; he said he was introduced to the Defendant by Mr. Ely, as I recall.

MR. HERNDON: Well, your Honor, may I make an offer of proof in the absence of the jury to preserve my record?

THE COURT: All right. Members of the Jury, I will excuse you briefly so that the defendant may make an offer of proof here which is something that should be made outside the presence of the jury and, if the court determines it is admissible, why then it will either be read to you or it will be repeated, one or the other.

You may now be excused and bear in mind the admonition I gave you earlier. This will be a brief recess, I think.

(Whereupon, the jury retired from the courtroom.)

THE COURT: You might ask the question, if you wish.

MR. HERNDON: Yes.

THE COURT: And make your offer in that

fashion.

MR. HERNDON: Yes, your Honor, thank you.

Now, Officer—first of all, was this Harvey Edwards an informant in connection with aspects of this case?

THE WITNESS: Yes, he was.

MR. HERNDON: And was he paid by the Bureau of Narcotics?

THE WITNESS: No, sir.

MR. HERNDON: Are you in charge of the payment of those funds?

THE WITNESS: No, sir. If I could add, if I paid an informant I would then be in charge of the payment but the payments to any informants are controlled by the district supervisor.

MR. HERNDON: The reason I ask you this question is my recollection in the previous case is you or one of your agents testified he was on the payroll in another case.

THE WITNESS: No, sir.

MR. HERNDON: All right; in any event, he was working in coordination with your Department; is that correct?

THE WITNESS: Yes, sir.

MR. HERNDON: And he agreed to do this at a time when you had a charge pending against him, is that correct?

THE WITNESS: Yes, sir.

MR. HERNDON: Now, did you or did you not have him, arrange to have him introduce the Sheriff Gordon to the Defendant?

THE WITNESS: No, sir.

MR. HERNDON: Did you have him introduce Sheriff Gordon to anyone?

THE WITNESS: Yes, sir.

MR. HERNDON: To whom?

THE WITNESS: Frank Ely.

MR. HERNDON: To a Frank Ely?

THE WITNESS: Yes, sir.

MR. HERNDON: And at the time he met Frank Ely, did he also meet this Defendant?

THE WITNESS: No, sir.

MR. HERNDON: It is your testimony that this Defendant was not present with Frank Ely and Mr. Harvey and Detective Gordon so far as your records reveal?

THE WITNESS: Yes, sir.

MR. HERNDON: So that the only thing, so far as you know, was he did introduce a Frank Ely to Detective—to Sheriff Gordon?

THE WITNESS: That is correct.

MR. HERNDON: I think that is as far as our proof will go and I will submit to the Court that this will be admissible because the Government has brought out in their case that Gordon's testimony was that he met Ely, he met Jackson through Ely, and this would complete the chain.

THE WITNESS: You said in the presence of the informant before.

MR. SWOFFORD: The informant is completely out of this case.

THE WITNESS: You asked me if the Deputy had met Jackson Morgan in the presence of the informant and I said no.

MR. HERNDON: But we have testimony, earlier testimony, that Gordon was introduced to Jackson Morgan by Frank Ely; so, it would then be admissible to show that Ely met the Gordon through his informant.

THE COURT: It is pretty remote, I think.

MR. SWOFFORD: It is, very.

THE COURT: You can make your offer and I will reject the offer.

MR. HERNDON: Very well.

THE COURT: Are you through then?

MR. HERNDON: That is all the questions I have. Well, I have a couple of more questions.

THE COURT: On cross examination or direct?

MR. HERNDON: On cross examination.

THE COURT: Then when they come back we will be on cross examination."

SPECIFICATION OF ERROR NO. 2

The court erred in restricting cross-examination of Agent Gordon about Harvey Edwards wherein the following occurred (Tr. 69-74) :

"Q. Now, do you know a Harvey Edwards?

A. Yes, sir, I do.

MR. SWAFFORD: Your Honor, I object to anything about him. I don't think anything was mentioned of that name on direct examination.

THE COURT: Well, it would appear so. Of course, you can make him your own witness, if you desire. If, in some respect, you state it is relevant I will accept your representation. Ordinarily, it would seem to me, you would bring it in as part of your own case in connection with your own witnesses, but you can make him your own witness, if you wish to.

MR. HERNDON: Your Honor, I intended to question this witness concerning his meeting of—

THE COURT: (Interposing) Well, you might proceed and I will see how far you go with it

and then you can renew your objection.

By Mr. Herndon:

Q. Now, this Mr. Harvey Edwards, was he employed by the Bureau of Narcotics at that time?

A. Do you mean was he on the payroll, sir?

Q. Was he receiving advance funds? He was, wasn't he?

A. No, sir.

MR. SWOFFORD: We object, your Honor. Again I can't see that this is relevant to any inquiry.

THE COURT: I will sustain the objection. I will sustain the objection to the last question.

By Mr. Herndon:

Q. Now, Deputy, where did you meet Harvey Edwards?

First—I will rephrase that—did you meet Harvey Edwards in connection with this case to which you were assigned?

A. Which case, sir?

Q. This general investigation you were conducting?

MR. SWOFFORD: I would object.

A. You will have to rephrase the question, sir.

MR. SWOFFORD: I can't see where it is relevant.

THE COURT: I will sustain the objection to the question as phrased.

By Mr. Herndon:

Q. Now, did you ever discuss with Harvey Edwards, Jackson Morgan?

A. No, sir, I did not.

Q. you had no conversation with Harvey Edwards about Jackson Morgan?

A. No, sir.

Q. Do you know where Harvey Edwards is new?

A. No, sir, I have no idea.

MR. HERNDON: Your Honor, we will ask that this witness be held.

THE COURT: He will be available, I assume.

THE WITNESS: Yes.

THE COURT: Is that what you mean by being available.

THE WITNESS: Yes.

MR. HERNDON: I better ask a couple of more questions.

THE COURT: All right.

By Mr. Herndon:

Q. Officer, now you have identified this material by your initials, is that correct?

A. Yes, sir.

Q. And now these advance funds, you have testified that advance funds are used to purchase narcotics, is that right?

A. Primarily, sir.

Q. And they are also used to pay informers?

A. No, sir.

MR. SWOFFORD: Objection; I don't think we have any testimony about informants here, your Honor.

THE COURT: Well, he answered the question.

By Mr. Herndon:

Q. Do you use different funds to pay informers MR. SWOFFORD: Your Honor —

THE COURT: (Interposing) I will sustain an objection to that question.

MR. HERNDON: Your Honor, for the purpose —

THE COURT: (Interposing) You can make him your own witness, if you want to, but this is not properly a part of cross examination. I think under objection before he answered the question and you pursued it further and I think the objection is properly taken.

By Mr. Herndon:

Q. (Continuing) Is it your testimony, Officer, that there is no informant involved in this case?

MR. SWOFFORD: Objection, your Honor. The issue here in this case is whether —

THE COURT: (Interposing) If you want to ask him the question, I don't think he has so testified yet.

By Mr. Herndon:

Q. (Continuing) Is there an informant involved in this case?

A. I have no knowledge of that, sir.

Q. You had no knowledge of any informant?

A. Not in this particular case.

MR. HERNDON: May I have a minute to look at the Jencks' Rule statement, your Honor?

THE COURT: Yes.

(Brief pause.)

MR. HERNDON: Just one more question.

By Mr. Herndon:

Q. Have you read — do you know what a Jencks' Rule statement is, Officer? A statement furnished, in this case furnished to the Defense, prior to trial?

A. Kind of vaguely.

THE COURT: Statement of a witness.

A. (Continuing) Vaguely.

By Mr. Herndon:

Q. Have you seen the witnesses' statement in this case?

A. Yes, sir.

Q. Have you seen the statement of Agent Joseph Ferro?

A. Yes, sir.

Q. Does that refer to an informant, or do you recall?

MR. SWOFFORD: Your Honor, I don't think this witness can be cross examined on a statement of a witness that government plans to call later.

THE COURT: I will sustain the objection."

ARGUMENT

These two assignments of error are being consolidated for argument purposes because the same issue is involved in both. It is conceded that the extent of cross-examination and the determination as to whether or not evidence is relevant is within the sound discretion of the trial court. The court allowed, in the case of Agent Ferro and Agent Gordon, the defendant to make the witnesses its own witnesses, so that the question of whether or not the propounded questions were within the scope of direct examination is not the issue, but the issue is as to whether or not the testimony should have been allowed into evidence, either in form of evidence elicited by cross-examination or in the form or part of the defendant's evi-

dence elicited by making the witness the defendant's witness rather than the plaintiff's.

It is respectfully submitted that the questions and answers proposed in defendant's offer of proof as set forth above were relevant. The defense contended in its opening statement that the case centered around Harvey Edwards and that Edwards was involved in some manner with Deputy Gordon. That Harvey Edwards introduced Jackson Morgan to Deputy Gordon (Tr. 37-38) and that the defendant had come to Seattle to do some business with Deputy Sheriff Gordon and that if there were any narcotics obtained they came from Edwards who was a narcotics addict and had been charged and convicted of narcotics violations. On the other hand in his testimony Deputy Sheriff Gordon claimed that he had been introduced to the defendant by a man by the name of Frank Ely (Tr. 44). It is submitted that we had the right to pursue the matter under cross examination to determine whether or not Gordon was in fact introduced to the defendant by Harvey Edwards and to explore whether or not this was a possible source of the narcotics contained in Exhibit 1 and 2, which the Government claimed were obtained from the defendant. The same holds true as to the questions and answers asked of Officer Ferro who was in charge of the investigation and the jury was entitled to hear the witnesses answer the questions and observe these witnesses when the questions asked and answers given to determine the credibility of the witnesses. One of the important aspects of cross examination regardless of

what the witnesses' answer may be, is for the jury to observe the witnesses in answering the questions so that their demeanor, facial expressions and voice can be observed and heard and it is respectfully submitted that the testimony which was rejected above by our offer of proof should have been heard by the jury. It is respectfully submitted that this limitation as to the admissibility of this testimony by the court and the restriction on the cross-examination materially affected the defendant's case as to all of the counts of the Indictment.

SPECIFICATION OF ERROR NO. 3

The court erred in denying defendant's motion for judgment of acquittal as to Counts I, II, III & IV, wherein the following occurred (Tr. 122-124):

"MR. HERNDON: May it please the Court, your Honor, I would like to make a motion.

THE COURT: All right, go ahead.

MR. HERNDON: The Defendant will move the Court at this time for a directed verdict of acquittal as to Counts I, II, III, IV, V and VI.

THE COURT: That is all there are.

MR. HERNDON: And VI of the Indictment for the failure of the Government to prove all of the allegations of each one of these Counts.

One of the allegations of the Counts I, II—I and II and —I and II is that it was unlawfully—knowing it to have been unlawfully imported into the United States contrary to law.

I am aware that there is a statutory presumption. However, by the statute you can't

make a dog a cat or change something from what it normally or naturally is and the presumption is not based upon any facts that gives rise to a presumption. The evidence here from the Government Chemist is that you can't—that it can be produced in this Country and we know that sometimes it is produced in this Country and the Government's jurisdiction in this type of case is based upon its being imported into this Country in violation of the law. It isn't a logical deduction and I know that the court in the past has upheld the existence of this presumption but we respectfully submit to the Court that it isn't based on logical reasoning and that the statute which gives rise to this presumption is also unconstitutional as it would have to be applied to the facts in this case in order to sustain it.

As to Count III there is no showing that this container is in its original stamped envelope because there is no showing what one of these stamps looked like and there is no evidence at all as to what one of these stamps are or what kind of container—what is the original container.

The same is true as to Count IV.

Your Honor, as to Count V and VI, I think the Government has introduced evidence in connection with each one of those.

THE COURT: Very well, the motion will be denied."

ARGUMENT

As to Counts I and II, it is respectfully submitted that the presumption created by the statute which in substantial part is as follows:

Title 21 U.S.C., Section 174 reads, in substantial part, as follows:

“Whoever knowingly imports any narcotic drug into the United States, or receives, conceals buys, sells, or in any manner facilitates the transportation, concealment, or sale of any such narcotic drug after being imported, knowing the same to have been imported or brought into the United States contrary to law, shall be imprisoned not less than five or more than 20 years, and, in addition, may be fined not more than \$20,000.

Whenever on trial for a violation of this Section, the defendant is shown to have or to have had possession of the narcotic drug, such possession shall be deemed sufficient evidence to authorize conviction unless the defendant explains the possession to the satisfaction of the jury.”

It is unconstitutional in that it raises a presumption that the narcotics in the possession of the defendant were unlawfully imported to the United States and that the defendant knew this. The testimony is clear in this case from the government witnesses that the narcotics in question could have been produced from poppies grown in the United States and that from time to time the chemist had examined narcotics produced from poppies grown in various parts of the United States.

We are aware of the decision in *Williams v. U. S.*, 290 F.2d 451 cited by the Ninth Circuit. However, it is respectfully submitted that the Court should review the question of the constitutionality of the presumption created by the statute. It is difficult to understand how the law can be constitutional when it is against the reason and logic to say that from the existence of possession of narcotics that a person knows that they were illegally imported to the United States when such a product can be produced in the United States and at least in some cases is going to be absolutely contrary to the facts of the case.

As to Counts III and IV, which are charges of violating Title 26, 4704 (a), which in part reads as follows:

“It shall be unlawful for any person to purchase, sell, dispense, or distribute narcotic drugs, except in the original stamped package or from the original stamped package and the absence of appropriate taxpaid stamps from narcotic drugs shall be prima facie evidence of a violation of this subsection by the person in whose possession the same may be found.”

In connection with Counts III and IV, again we have a presumption that has been upheld in *Smith v. U.S.*, 273 F.2d 462, it is respectfully submitted, however, that in this case such a presumption is unconstitutional in that the statute says “in or from the original stamped package.” There is no showing that these were not from an original stamped package.

The statute simply states this fact to be so in order to give the federal court jurisdiction. When in fact, and in truth, in many cases the material could come from an original stamped package. The only way this can be rebutted in the case in point was to require the defendant to testify in violation of the Fifth Amendment to the Constitution that both statutes set forth above creates presumption that require a defendant to produce evidence and in many instances to testify. This is contrary to our constitution and our basic philosophy that a defendant need not prove anything and that the burden of proof is on the State and the defendant should not be required to testify.

SPECIFICATION OF ERROR NO. 4

The court erred in instructing the jury that possession of narcotic drugs by the defendant was sufficient to raise a presumption that the narcotic drugs had been illegally imported into the United States and that the defendant knew that it had been illegally imported to the United States, wherein the following occurred (Tr. 166-167, 169, 179-180):

“I instruct you that as to Counts I and II that although the Defendant is charged with concealing and selling a quantity of narcotic drugs it is not necessary for the United States to prove that the Defendant did both of the acts charged but it is only necessary that the United States prove that the Defendant did conceal or sell.

In Section 174, with which we are concerned in Counts I and II, there is this further provision which I will read:

‘Whenever on trial for a violation of this section the Defendant is shown to have had possession of the narcotic drug, such possession shall be deemed sufficient evidence to authorize conviction unless the Defendant explains the possession to the satisfaction of the jury.’

The statute just read does not change the fundamental rule that the Defendant is presumed innocent until proved guilty beyond a reasonable doubt, nor does it impose upon the defendant any burden or duty to produce proof that narcotic drug was imported, or any other evidence. As previously stated, the burden is always upon the prosecution, that is the government, to prove beyond a reasonable doubt every essential element of the crime charged. What the statute means, the portion I have just read, is that upon a trial for a violation thereof, if the Jury should find beyond a reasonable doubt that the defendant has had possession of the narcotic drug as charged, the fact of such possession alone, unless explained to the satisfaction of the jury by the evidence in the case, permits the jury to draw the inference and find that the narcotic drug was imported or brought into the United States of America contrary to law, and to draw the further inference and find that the defendant had knowledge that the narcotic drug was imported or brought in contrary to law.

In connection with any explanation offered for possession of a narcotic drug, you are reminded that in the exercise of a Constitutional right the Defendant need not testify. Possession may be explained to the satisfaction of the jury through

other circumstances and other evidence in the case independent of the testimony of a defendant.

In connection with any explanation offered for possession of any narcotic drug, you are again reminded that in the exercise of his Constitutional rights a defendant need not testify. Possession may be explained to the satisfaction of the jury through other circumstances and other evidence in the case independent of testimony of the accused.

MR. HERNDON: And we object to, although the Court has to some degree covered this, the giving of our Requested Instruction Number Ten in a modified form and in connection with the objection, your Honor, we have objection to the Court having read the statute which says that possession is — raises a presumption and inference that the Defendant knew that the drug was unlawfully, imported into the United States.

And, by instructing the jury that a presumption is raised by possession of narcotics not bearing a revenue stamp that the narcotics did not come from the original stamped envelope wherein the following occurred (Tr. 167-169, 180):

“Also, with respect to Counts IV and V—III and IV, rather, Section 4704 (a) of Title 26 of the United States Code provides that the proof of:

‘The absence of appropriate tax paid stamps from narcotic drugs shall be prima facie evidence of a violation of this section by the person in whose possession the narcotic drugs may be found.’

Prima facie evidence of a violation means such evidence as would warrant a verdict of guilty unless overcome or outweighed by the other evidence in the case. That is to say, unless the evidence in the case leads the jury to a different or contrary conclusion.

However, this statute does not change the fundamental rule that the accused is presumed innocent until proved guilty beyond a reasonable doubt, nor does it impose upon a defendant the burden or duty to produce proof that the narcotic drug tax was paid as required by law, or any other evidence. As previously stated, the burden is always upon the prosecution to prove beyond a reasonable doubt every essential element of the crime charged. What the statute means is that, upon a trial for a violation thereof, if the jury should find beyond a reasonable doubt from the evidence in the case that the defendant has had possession of the narcotic drugs, not bearing the tax paid revenue stamps required by law as charged, the fact of such possession alone, unless explained to the satisfaction of the jury by the evidence in the case, permits the jury to draw the inference and find that the narcotic drug was distributed in or from an unstamped package as charged and to draw the further inference and find that the defendant had knowledge that the narcotic drug was distributed in or from a package not bearing the tax paid revenue stamps required by law as charged in the Indictment.

MR. HERNDON: But we object to the reading of the statute requiring the Defendant—the

statute saying that the Defendant has to produce evidence as to—or explain the possession.

We feel that the statute is unconstitutional and that the inference—that it does not lead to the inference that it directs the jury to draw from mere possession, and we object to the same, our request that is in Instruction Number Eleven, we object to the Court giving that in a somewhat modified form and we also object to the instruction as to the inferences, the instruction the Court gave as to the inferences that could be drawn from the absence of a stamp and from not being in its original form.

THE COURT: Very well.”

ARGUMENT

The exception as to the two different instructions concerning the presumptions are compiled into one objection because the same issue of constitutionality is raised.

The argument asserted as to the court's failure in allowing the directed verdict or judgment of acquittal as to Counts I, II, III & IV is again asserted in connection with the court's instructions in that the presumption raised by the statutes are unconstitutional.

SPECIFICATION OF ERROR NO. 5

The court erred in failing to give defendant's requested Instruction No. 2 and in giving the same in a modified form, which requested Instruction No. 2 reads as follows:

REQUESTED INSTRUCTIONS NO. 2

“Every witness is presumed to speak the truth. This presumption may be overcome by the manner in which he or she testifies, by the character of his or her testimony, by evidence affecting his or her character or motive, or by contradictory evidence.

“A witness shown to be false in part of his or her testimony is to be distrusted in others. Therefore, if you find that any witness has wilfully sworn falsely to any part of his or her testimony, you have the right to distrust the other portions thereof. You are instructed that if the consideration of all the evidence in this case the same is acceptable of two conclusions or two constructions, one consistent with the guilt of the defendant and the other consistent with his innocence, then you are to adopt that construction or conclusion which is most consistent with his innocence.”

State v. Leland, 190 Or 598.

ARGUMENT

Although the court gave a portion of defendant's Instruction No. 2 in modified form, the court did not instruct the jury, which the defendant contends is the law,

“You are instructed that if from consideration of all the evidence in this case the same is acceptable of two conclusions or two constructions, one consistent with the guilt of the defendant and the other consistent with his innocence, then you are to adopt that construction or

conclusion which is most consistent with his innocence."

and we feel that the failure to give this instruction is prejudicial in that the jury in applying this principal of law, had they been so instructed, might have reached another conclusion as to one or all of the counts.

CONCLUSION

For all of the foregoing reasons, it is respectfully submitted that the Court should grant the defendant a new trial.

Respectfully submitted,

JULIAN HERNDON, JR.,
HERNDON & WHITNEY,
Of Attorneys for Appellant.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

JULIAN HERNDON, JR.
Of Attorneys for Appellant

United States
Court of Appeals
For the Ninth Circuit

JACKSON MORGAN,
Appellant,

v.

UNITED STATES OF AMERICA,
Appellee.

Appellant's Petition for Rehearing

JULIAN HERNDON, JR.
Suite 300, Helm Building
Portland, Oregon
Attorney for Appellant.

FILED
JUN 10 1936
WILLIAM L. LUCAS, CLERK

United States
Court of Appeals
For the Ninth Circuit

JACKSON MORGAN,
Appellant,

v.

UNITED STATES OF AMERICA,
Appellee.

Appellant's Petition for Rehearing

To the United States Court of Appeals for the Ninth Circuit and the Judges Thereof:

Appellant in the above-entitled cause, presents this, his petition for a rehearing of the above-entitled cause, and in support thereof respectfully shows:

I.

Appellant reiterates his objection to the Constitutionality of the presumptions created by the statute as assigned as Error Nos. 3 and 4 in Appellant's Opening Brief. It is respectfully submitted that Title 21 U.S.C., Section 174, is invalid because it raises the presumption that narcotics in the possession of the defendant were

unlawfully imported and that the defendant knew this. Title 26, 4704 (a) further raises a presumption that the absence of appropriate taxpaid stamps from narcotic drugs shall be prima facie evidence of a violation of the statute. It is urged once again that Title 21 U.S.C., Section 174 is unconstitutionally vague because it is against reason and logic to say that from the existence of possession of narcotics that a person knows that they were illegally imported to the United States when such product can be produced in the United States and at least in some cases is going to be contrary to the facts of the case.

It is further reiterated that both sections violate the Fifth Amendment because they can be rebutted only by requiring the defendant to testify and produce evidence to explain away the presumption.

II.

It is urged once again that the Court below erred in limiting the cross-examination of some of the State's witnesses designed to place their testimony in proper perspective.

III.

It is further reiterated that the Court below erred in failing to give the whole of defendant's requested instruction No. 2.

-43

For the reasons stated above, petitioner requests that a rehearing be granted and that on rehearing the judgment of this Court be reversed and the judgment of the United States District Court be reversed.

Dated this 11 day of April, 1968.

Respectfully submitted,

Attorney for Appellant.

Jackson Morgan, appellant herein, by his attorney, hereby certifies that the foregoing petition for rehearing is not presented for the purpose of delay or vexation, but is, in the opinion of counsel, well founded in law, and proper to be filed herein.

Dated this 11 day of April, 1968.

Attorney for Appellant.

STATE OF OREGON }
 County of Multnomah } ss.

I, JULIAN HERNDON, JR., being first duly sworn on oath, depose and say:

That I served a copy of the foregoing Appellant's Petition for Rehearing on Michael J. Swofford, Deputy U.S. Attorney, attorney for Appellee, on the // day of April, 1968, by mailing to him a true and correct copy thereof, certified by me as such, prior to mailing Appellant's Petition for Rehearing to the United States Court of Appeals for the Ninth Circuit. I further swear that said copy was placed in a sealed envelope addressed to said attorney at U.S. Courthouse, Seattle, Washington, his last known address, and deposited in the Post Office at Portland, Oregon, on the // day of April, 1968, and that the postage thereon was prepaid.

SUBSCRIBED AND SWORN TO before me this
 // day of April, 1968.

NOTARY PUBLIC for Oregon
 My Commission expires: 4/13/70

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JACKSON MORGAN,
Appellant,

v.

UNITED STATES OF AMERICA,
Appellee.

NO 5 1 1 5 7

21811

BRIEF OF APPELLEE

Appeal from the United States District Court
for the Western District of Washington
Northern Division
Honorable William J. Lindberg
District Judge

FILED

OCT 19 1967

WM. B. LUCK, CLERK

EUGENE G. CUSHING
United States Attorney

MICHAEL J. SWOFFORD
Assistant United States Attorney

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1 STATEMENT OF JURISDICTION 1/

2 Appellant was charged in the sixth count indictment with
3 violation of the Federal Narcotic laws. Said indictment is
4 set forth as follows (CT 2):

5 "The Grand Jury charges:

6 COUNT I

7 That on or about March 21, 1966 at Seattle, Wash-
8 ington, within the Northern Division of the Western
9 District of Washington, JACKSON MORGAN did knowingly
10 and unlawfully conceal and sell a quantity of narcotic
11 drugs, to wit, approximately 66.921 grams of heroin
12 hydrochloride, knowing the same to have been imported
13 into the United States contrary to law.

14 All in violation of Title 21, U.S.C. , Section 174.

15 COUNT II

16 That on or about April 11, 1966 at Seattle, Wash-
17 ington, within the Northern Division of the Western
18 District of Washington, JACKSON MORGAN did knowingly
19 and unlawfully conceal and sell a quantity of narcotic
20 drugs, to wit, approximately 30.009 grams of heroin
21 hydrochloride knowing the same to have been imported
22 into the United States contrary to law.

23 All in violation of Title 21, U.S.C., Section 174.

24 COUNT III

25 That on or about March 21, 1966 at Seattle, Wash-
ington, within the Northern Division of the Western
District of Washington, JACKSON MORGAN did knowingly
and unlawfully sell, dispense and distribute a quantity
of narcotic drugs, to wit, approximately 66.921 grams
of heroin hydrochloride, not in or from the original
stamped package.

 All in violation of Title 26 U.S.C., Section
4704(a).

1/ In this brief (CT) will refer to the number of the
records herein given by the Clerk of the Court for the
Western District of Washington. (Tr) will refer to the Court
Reporter's transcript of proceedings. (Ex) will refer to
exhibits.

COUNT IV

"That on or about April 11, 1966 at Seattle, Washington, within the Northern Division of the Western District of Washington, JACKSON MORGAN did knowingly and unlawfully sell, dispense and distribute a quantity of narcotic drugs, to wit, approximately 30.009 grams of heroin hydrochloride, not in or from the original stamped package.

All in violation of Title 26 U.S.C., Section 4704(a).

COUNT V

That on or about March 21, 1966 at Seattle, Washington, within the Northern Division of the Western District of Washington, JACKSON MORGAN did knowingly and unlawfully sell a quantity of narcotic drugs, to wit, approximately 66.921 grams of heroin hydrochloride, not in pursuance of a written order of the person to whom such heroin hydrochloride was sold on a form issued in blank for that purpose by the Secretary of the Treasury or his delegate.

All in violation of Title 26 U.S.C., Section 4705(a).

COUNT VI

That on or about April 11, 1966, at Seattle Washington, within the Northern Division of the Western District of Washington, JACKSON MORGAN did knowingly and unlawfully sell a quantity of narcotic drugs, to wit, 30.009 grams of heroin hydrochloride, not in pursuance of a written order of the person to whom such heroin hydrochloride was sold on a form issued in blank for that purpose by the Secretary of the Trasury or his delegate.

All in violation of Title 26 U.S.C., Section 4705(a)."

Defendant entered a plea of not guilty as to each count on August 16, 1966, (CT 3) and was tried by a jury on January 4, 1967 (Tr). A verdict of guilty was returned by the jury on each count of the indictment on January 4, 1967,

1 and on January 27, 1967, Judgment, Sentence, and Commitment
2 was pronounced and imposed on all counts of the indictment
3 (CT 9).

4 Jurisdiction of the District Court was based on Title
5 18 U.S.C., Section 3231. This Court has jurisdiction in the
6 Appeal under Title 28, U.S.C. Section 1291.

7
8 COUNTERSTATEMENT OF THE CASE

9 The testimony taken at the trial established the
10 following:

11 Joseph Gordon, a King County Deputy Sheriff, was loaned
12 to the Federal Bureau of Narcotics to serve as an undercover
13 agent (Tr 43) and in such capacity was introduced to the
14 defendant, JACKSON MORGAN, on January 13, 1966, by a person
15 named Frank Ealey. Said initial meeting took place in an
16 apartment house located at 2801 Yesler Way, Seattle, Washing-
17 ton, and the only persons present were the defendant, Frank
18 Ealey, and Deputy Sheriff Joseph Gordon (Tr 44). On March 21,
19 1966, Deputy Sheriff Gordon received a telephone call from
20 Defendant Jackson Morgan who advised Gordon that he would be
21 in Seattle in approximately three hours (Tr 45) after which
22 call Deputy Gordon was furnished with \$700.00 of official
23 advance funds with which to purchase narcotics from Defendant
24 Morgan (Tr 48). Later on said date, Deputy Gordon met
25 Defendant Morgan at a Union 76 station in Seattle at which

1 time Morgan offered to sell narcotics to Gordon (Tr 50).
2 A moment thereafter, Defendant Morgan took a small rubber
3 container from his pocket and handed it to Deputy Gordon
4 (Tr 51) after which Gordon gave Morgan the \$700.00 in
5 official advance funds (Tr 52). The rubber container con-
6 tained a grayish white powder which later proved to be
7 61.692 grams of heroin hydrochloride (TR 110 and 112). There
8 was no tax paid stamp affixed to the container (Tr 53) and
9 Deputy Gordon did not have an order signed in blank by the
10 Secretary of Treasury or his delegate for the sale of
11 narcotics (Tr 53). The activities of Deputy Gordon and
12 Defendant Morgan at the Union 76 station were observed from
13 a surveillance post by Agent Joseph Ferro, who was the
14 Senior Agent in charge of the case (Tr 81).

15
16 On April 11, 1966, Defendant Morgan again called Deputy
17 Gordon during which telephone conversation defendant offered
18 to sell Gordon more narcotics (Tr 60). Deputy Gordon was
19 subsequently furnished with \$350.00 in official advance funds
20 by Agent Ferro (Tr 61) and then met the defendant at the
21 Union 76 station at Rainer and Jackson Streets in Seattle
22 (Tr 63). Deputy Gordon entered Defendant Morgan's car and
23 the defendant sold a rubber container containing a grayish
24 powder to Deputy Gordon for \$350.00 (Tr 64). The powder con-
25 tained within the rubber container proved to be 30.009 grams
of heroin hydrochloride (Tr 114). The container did not have

1 a tax paid stamp affixed to it, and Deputy Gordon did not
2 have a written order from the Secretary of the Treasury or
3 his delegate authorizing the sale of narcotics (Tr 65 and
4 66). Narcotic Agent Joseph Ferro observed the activities
5 between Defendant Morgan and Deputy Gordon at the Union 76
6 station from a surveillance point (TR 87).

7 8 QUESTIONS PRESENTED

9 1. Whether the Trial Judge properly sustained Govern-
10 ment's objection to certain testimony on grounds that it was
11 irrelevant.

12 2. Whether the presumptions contained within 21 U.S.C.,
13 Section 174 and 26 U.S.C., Section 4704(a) are constitutional.

14 3. Whether appellant was prejudiced by the Court's
15 giving his Requested Instruction No. 2 in modified form.

16 17 SUMMARY OF ARGUMENT

18 I. The Trial Court properly limited certain questions
19 on cross-examination for being irrelevant and too remote.

20 a. Whether or not evidence is relevant is
21 within the sound discretion of the Trial
22 Court.

23 b. Testimony as to a person called Harvest
24 Edwards was irrelevant and was properly
25 limited.

1 II. The presumptions contained in 21 U.S.C. Section
2 174 and 26 U.S.C. Section 4704(a) have been repeatedly held
3 to be constitutional.

4 III. Appellant was not prejudiced when the Court gave
5 his Requested Instruction No. 2 in modified form.

6
7 ARGUMENTS

8 I & II

9 THE TRIAL COURT PROPERLY LIMITED CERTAIN
10 QUESTIONS ON CROSS-EXAMINATION ON GROUND
OF IRRELEVANCY AND REMOTENESS.

11 Appellant argues in specification of error No. 1 and 2,
12 (which will be covered together in this brief) that the
13 trial court erred in restricting the appellant's cross-
14 examination of Agents Gordon and Ferro. Specifically,
15 appellant was attempting to elicit information from said
16 Agents concerning the involvement of a person named Harvey
17 Edwards in this case. After allowing some questioning in
18 said area, the trial court sustained the government's objec-
19 tion to this line of cross-examination on grounds that it
20 lacked relevancy due to remoteness. In the appellant's words,
21 "... the issue is as to whether or not the testimony should
22 have been allowed into evidence..." (appellant's brief
23 page 15).

24 The law is clear that the determination of whether or
25 not evidence is relevant and should be received is within

1 the sound discretion of the trial court. Glasser v. United
2 States, 315 US 60; Beck v. United States, 298 F 2d 622, 629
3 (9th Cir. 1962). Even the appellant admits this to be the
4 law where he states in his brief that (page 15)

5 "It is conceded that the extent of cross-examination
6 and the determination as to whether or not evidence
7 is relevant is within the sound discretion of the
8 trial court."

9 Hence, it is difficult to visualize how the trial court's
10 rulings on the admissibility of evidence in this case can be
11 an issue in this appeal.

12 It appears as if the only available issue is the
13 possible question of prejudicial abuse of discretion by the
14 trial judge in ruling the evidence irrelevant. However,
15 appellant does not make an argument for this proposition and
16 makes no showing that the excluded evidence would have
17 affected the outcome of the trial. The evidence pointing to
18 the defendant's guilt as to the charges contained in the
19 indictment was overwhelming, consisting of the direct
20 testimony of Agent Joseph Gordon, who was a King County
21 Deputy Sheriff working as an undercover agent for the Federal
22 Bureau of Narcotics at the time of the two sales of narcotics,
23 and the corroborating testimony of Senior Agent Joseph Ferro.
24 Deputy Gordon, the purchaser of the narcotics, testified in
25 great detail as to the actual sale transactions which took
place at the Union 76 station on corner of Rainier Avenue

1 and as to his conversations with the defendant. Agent Ferro
2 observed both of the sale transactions and corroborated
3 Deputy Gordon's testimony.

4 The defendant's attempt during cross-examination to
5 implicate a person called Harvey Edwards in the transactions
6 appears to have been a smoke screen to divert the jury's
7 attention from the real elements of the crime charged.
8 Defense counsel advised the court that he was attempting to
9 prove that the United States Bureau of Narcotics had paid
10 Harvest Edwards to introduce Deputy Gordon, the undercover
11 agent, to the defendant in this case (Tr 95).

12 In response to the defense's question in this area,
13 Gordon stated on cross-examination that he was acquainted
14 with an informant named Harvey Edwards (Tr 69), but that no
15 informant was involved in the case against Defendant Morgan
16 (Tr 73) and that he had never discussed Defendant Morgan with
17 Harvey Edwards (Tr 71). Deputy Gordon further testified that
18 he was introduced to Defendant Morgan on January 13, 1966, by
19 a person called Frank Ealey and that Harvey Edwards was not
20 present at the introduction (Tr 44). Furthermore, the record
21 shows that no third person was present or took part in the
22 two sale transactions at the Union 76 station or in the
23 arrangements for said transactions. Also, Agent Ferro, who
24 was in charge of the case, testified that Harvey Edwards had
25 introduced Agent Gordon to Frank Ealey in another case, but

1 that Harvey Edwards had no part in the case against defendant
2 Morgan (Tr 98). Therefore, the Court properly limited
3 cross-examination on the subject of Harvest Edwards because
4 Edwards had no part in the case against Defendant Morgan.

5 The defense attorney was certainly aware at the very
6 beginning of the trial of the existence of a person called
7 Harvey Edwards, as indicated from his opening statement
8 (Tr 37 through 39) where he states that Harvey Edwards had
9 worked at the World's Fair and from time to time had sold
10 clothing to Jackson Morgan. If Harvey Edwards was involved
11 in any way in the case against Defendant Morgan , it seems
12 logical to assume that defense counsel would have called
13 Harvey Edwards as a defense witness, as suggested by the
14 Court (Tr 69). Also, defendant had in his possession all
15 the Jencks Act statements written by the narcotics agent
16 (Tr 73) and could have used these documents for impeachment
17 purposes, if they contained contradictory statements.
18 However, he chose not to call either Harvey Edwards or to use
19 the Jencks Act statements.

20 In view of the overwhelming evidence concerning the
21 sale transactions between the defendant and Deputy Gordon,
22 it is impossible to visualize how the outcome of the case
23 could have been altered by allowing more questions concerning
24 Harvey Edwards. Accordingly, the trial court did not abuse
25 its discretion in limiting this line of inquiry for being too
remote and irrelevant.

III & IV

A. THE PRESUMPTION CONTAINED IN 21 U.S.C. SECTION 174 IS CONSTITUTIONAL.

Appellant contends that the presumption contained within 21 U.S.C. Section 174 is unconstitutional. Said section reads as follows:

"Whenever on trial for a violation of this section, the defendant is shown to have or to have had possession of the narcotic drug, such possession shall be deemed sufficient evidence to authorize conviction unless the defendant explains possession to the satisfaction of the jury." 21 U.S.C. Section 174.

The constitutionality of said presumption has been tested before the courts which have repeatedly upheld its constitutionality. Brown v. United States, 370 F. 2d 874 (9th Cir. 1966); United States v. Secondino, 347 F. 2d 725 (2nd Cir. 1965); Orozco-Vasquez v. United States, 244 F. 2d 837 (9th Cir. 1965); Agovian v. United States, 323 F. 2d 693 (9th Cir. 1963); United States v. Gainey, 380 US 63, 85 S. Ct. 754, 13 L.Ed. 2d 550.

Appellant relies upon part of the testimony of the United States Chemist to the effect that the opium poppy can be grown in the United States. It should be noted, however, that the growing of opium poppies in the United States is prohibited by law. 21 U.S.C. Section 188(b). In spite of this testimony by the chemist, there is no other evidence by which the defendant's possession of the narcotics in

1 question could be explained. Hence, the jury could properly
2 follow the court's instruction regarding the presumption
3 that unexplained possession would authorize conviction.

4 B. THE PRESUMPTION CONTAINED IN
5 21 U.S.C. SECTION 4704(a) IS
6 CONSTITUTIONAL.

7 Appellant argues that the presumption contained in
8 Title 26 U.S.C. Section 4704(a) is unconstitutional. Said
9 presumption reads as follows:

10 ".... the absence of appropriate taxpaid stamps
11 from narcotic drugs shall be prima facie evidence
12 of a violation of this subsection by the person
13 in whose possession the same may be found."
14 21 U.S.C. Section 4704(a).

15 Said presumption has been held to be constitutional in
16 Smith v. United States, 273 F. 2d 462 (10th Cir. 1959).

17 Appellant contends that in order to rebut the presumption
18 and explain his possession of the narcotics it would be
19 necessary for him to take the witness stand and testify,
20 such requirement violating his Fifth Amendment right to
21 remain silent at trial. The United States Supreme Court has
22 held in United States v. Gainey, 380 US 63 that this type of
23 presumption does not violate the defendant's Fifth Amendment
24 right. This circuit has held likewise in Brown v. United
25 States, 370 F. 2d 874 (9th Cir. 1966).

Furthermore, there is ample evidence at the trial to get
these two counts of the indictment to the jury and to justify
the court's refusal of defendant's motion for a directed

1 verdict of acquittal. Sufficient evidence is as follows:

2 1. The absence of the necessary tax stamps was
3 established by the testimony of Agent Gordon
4 (Tr 53, 65, and 66).

5 2. The narcotics and their containers were
6 admitted into evidence as government's exhibits
7 Number 1 and 2. The jury could therefore examine
8 said exhibits and note that the necessary tax
9 stamps were not affixed thereto. Furthermore,
10 Agent Gordon testified that the containers were
11 in the identical condition as they were at the
12 time he purchased the narcotics from Defendant
13 Morgan (Tr 66, Tr 51 and 52).

14 Therefore it can be concluded that the trial court
15 properly denied defendant's motion for a judgment of
16 acquittal on accounts 1, 2, 3 and 4 and properly instructed
17 the jury as to the law relating to the presumptions of
18 illegal importation and the absence of tax paid stamps.

19
20 V.

21 THE GIVING OF DEFENDANT'S REQUESTED
22 INSTRUCTION NUMBER 2 IN MODIFIED FORM
DID NOT PREJUDICE DEFENDANT'S CASE.

23 Appellant argues that the Court prejudiced his case when
24 it did not state verbatim that if the evidence was acceptable
25 of two conclusions or constructions, one consistent with the

1 guilt of the defendant and the other consistent with his
2 innocence, that the jury should adopt that construction or
3 conclusion which is most consistent with the defendant's
4 innocence.

5 It should be noted first that appellant's brief does
6 not cite any Federal cases in support of his contention.
7 Secondly, the transcript reveals that the evidence pointing
8 to appellant's guilt was so overwhelming that it could only
9 point to one conclusion. There was not a close issue of fact
10 in this case. And lastly, the Court's instructions covered
11 in great detail the area of presumption of innocence and
12 reasonable doubt. A few excerpts from said instructions are
13 quoted herein.

14 "The law presumes the defendant to be innocent
15 of the crime. Thus, the defendant, although
16 accused, begins a trial with a clean slate;" (Tr 156).

17 "...the presumption of innocence is also
18 sufficient to acquit the defendant unless the
19 jurors are satisfied beyond a reasonable doubt
20 of the defendant's guilt from all of the
21 evidence in the case." (Tr 157).

22 "Defendant is not to be convicted on the mere
23 suspicion or conjecture." (Tr 157).

24 "Reasonable doubt exists in any case when, after
25 careful and impartial consideration of all the
evidence, the jurors do not feel convinced to a
moral certainty that a defendant is guilty of
the offense or offenses charged." (Tr 157).

Considering the overwhelming evidence pointing to the
defendant's guilt, and the Court's careful and detailed


1 instructions as to presumption of innocences and reasonable
2 doubt, it is impossible to see how the Court possibly could
3 have prejudiced defendant's case when it gave his requested
4 instruction Number 2 in modified form.

5
6 CONCLUSION

7 Deputy Sheriff Joseph Gordon testified that on
8 March 21, 1966, and April 11, 1967, he purchased narcotic
9 drugs, heroin hydrochloride, from the defendant, Jackson
10 Morgan. There were no third parties involved in the trans-
11 action. Agent Gordon's testimony was not impeached during
12 cross-examination, and Agent Joseph Ferro also observed both
13 sale transactions from a surveillance point. There was no
14 testimony either directly or indirectly that said sales did
15 not take place as described by Agent Gordon. Accordingly,
16 the evidence overwhelmingly pointed to Defendant Morgan's
17 guilt of the crimes charged in the Indictment and the Govern-
18 ment respectfully urges that this Court affirm the judgment
19 and conviction entered in the District Court.

20 Respectfully submitted,

21 
22 EUGENE G. CUSHING
23 United States Attorney

24 
25 MICHAEL J. SWOFFORD
Assistant U.S. Attorney

1
2 CERTIFICATE OF COUNSEL

3 I certify that in connection with the preparation of
4 this brief I have examined Rules 18 and 19 of the United
5 States Court of Appeals for the Ninth Circuit and that in
6 my opinion the foregoing brief is in full compliance with
7 those rules.
8

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10 
11 MICHAEL J. SWOFFORD
12 Assistant U.S. Attorney
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THEORY OF THE EARTH

The theory of the earth is a branch of geology which deals with the origin and development of the earth and its various parts. It is a science which seeks to explain the processes which have shaped the earth and its various parts. The theory of the earth is a branch of geology which deals with the origin and development of the earth and its various parts. It is a science which seeks to explain the processes which have shaped the earth and its various parts.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

HOTPOINT DIVISION OF GENERAL)
ELECTRIC COMPANY, a New York)
corporation,)

Appellant,)

vs.)

NO. 21812

CHARLES D. McCARTY, as Trustee)
in Bankruptcy for THE LUSK COR-)
PORATION, et al,)

Appellee.)

APPELLANT'S OPENING BRIEF

LESHER, SCRUGGS, RUCKER, KIMBLE & LINDAMOOD
3773 East Broadway
Tucson, Arizona
Attorneys for Appellant

RECEIVED AND FILED this ____ day of July, 1967.

FILED

JUDGE, UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

WILLIAM L. LUCK, CLERK

JUL 10 1967

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APPELLANT'S OPENING BRIEF

STATEMENT OF JURISDICTION

Jurisdiction of the District Court is conferred by 11 U.S.C. 511 to 521. Jurisdiction of this Court of Appeals is conferred by 11 U.S.C. 24 and 11 U.S.C. 521.

These proceedings originated in the District of Arizona; said district is within the jurisdiction of the Circuit Court of Appeals for the Ninth Circuit. Jurisdiction appears from the original petition for reorganization under Chapter X of the Bankruptcy Act filed by creditors against The Lusk Corporation in Case No. B-5696-Tuc. on October 28, 1965 (Tr: 4^{*}), and from the voluntary petition for reorganization under Chapter X of the Bankruptcy Act filed in B-5720-Tuc. on November 4, 1965 (Tr: 81), by The Lusk Corporation, The Lusk Corporation of Tucson, Inc., Broadway Construction Company of Tucson, Inc., The Lusk Corporation of Phoenix, Inc., Broadway Construction Company of Phoenix, Inc., and Construction Components, Inc., Debtors, and from the Notice of Appeal filed by the Appellant in this court on February 17, 1967, in B-5696-Tuc. and B-5720-Tuc. (Tr: 142).

*NOTE: Throughout the Brief, the Transcript of Record will be referred to as "Tr:" plus the page number thereof, as "Tr: 25," and unless otherwise specified, the page numbers referred to will be from Vol. I of said transcript.

STATEMENT OF THE CASE

Case No. B-5696-Tuc. originated with an involuntary petition for corporate reorganization of The Lusk Corporation filed pursuant to the provisions of 11 U.S.C. 526 by three unsecured creditors of said corporation (Tr: 4). Case No. B-5720-Tuc. originated by the filing of a voluntary petition for reorganization under Chapter X of the Bankruptcy Act by The Lusk Corporation and its subsidiaries listed in the petition pursuant to the provisions of 11 U.S.C. 528 (Tr: 81). Simultaneously with the filing of its voluntary petition in B-5720-Tuc., The Lusk Corporation answered the creditors' petition filed against it in B-5696-Tuc. and admitted all of the allegations contained in said involuntary petition required to be alleged by 11 U.S.C. 530, but denied the allegations therein contained required to be alleged by 11 U.S.C. 131 (Tr: 19). At the time of the filing of the involuntary petition in B-5696-Tuc., it was endorsed on the first page thereof by the District Judge as follows: "The above-entitled proceedings are referred to Hon. Hugh M. Caldwell, Referee in Bankruptcy, to hear and determine all matters not specifically reserved to the judge, and, as Special Master, to hear and report on all matters specifically reserved to the judge. October 28, 1965, at 3:20 p.m. James A. Walsh, U.S.D.J." (Tr: 4).

After the filing of the voluntary petition in B-5720-Tuc. by The Lusk Corporation and its subsidiaries on November 4, 1965, the Judge of the District Court entered a order on November 5, 1965, approving the petition as properly filed under Chapter X of the Bankruptcy Act and restraining mortgage foreclosures and other actions against the debtors' properties (Tr: 86). On the same day, he entered an order appointing a Trustee in B-5720-Tuc. (Tr: 88), and on November 8, 1965, in B-5720-Tuc. the court entered an Order of Reference referring the matter to Honorable Hugh M. Caldwell "to hear and determine all matters not specifically reserved to the judge, and, as special master, to hear and report on all matters specifically reserved to the judge" (Tr: 89).

Within the time for a debtor to answer an involuntary petition (11 U.S.C. 536), this Appellant filed an answer to the involuntary petition in B-5696-Tuc. challenging the allegations therein contained and required to be pleaded by 11 U.S.C. 531 (Tr: 26). Simultaneously therewith, this Appellant, on November 5, 1965, filed a motion to dismiss the involuntary proceedings in B-5696-Tuc., charging, among other reasons, that the proceeding had become moot by reason of the filing of the voluntary petition in B-5720-Tuc. (Tr: 24).

On December 6, 1965, in B-5696-Tuc., the petitioning creditors moved the court to approve the involuntary petition, contending that The Lusk Corporation had consented to the petition by the admissions contained in its answer (Tr: 33). On the same day, the Trustee appointed in B-5720-Tuc. for The Lusk Corporation and its subsidiaries (Tr: 88, 93) intervened in B-5696-Tuc. and moved the court to approve the involuntary petition filed by the creditors, taking the identical position urged by the petitioning creditors that the answer filed by Debtors was a sufficient admission of all necessary facts to in effect eliminate any issues between Debtors and petitioning creditors (Tr:46).

In B-5720-Tuc., under date of November 17, 1965, the judge required that a hearing be held on the 4th day of January, 1966, pursuant to the provisions of Section 161 of the Bankruptcy Act (11 U.S.C. 561) (Tr: 101). In B-5720-Tuc., no answer raising any issue under Section 130 of the Bankruptcy Act (11 U.S.C. 530) was filed by any creditor within the time fixed for the Section 161 hearing above referred to (docket pages in B-5696-Tuc. and B-5720-Tuc.).

Subsequent to the entry of the order in B-5720-Tuc. approving the petition as properly filed (Tr: 86), the business and affairs of The Lusk Corporation and its subsidiaries were,

have been, and still are being administered by the Trustee appointed in B-5720-Tuc.

Following the motion to dismiss filed by General Electric and the motion made by the Trustee and the petitioning creditors, predicated upon the contention that the answer filed by The Lusk Corporation was an admission of the material facts alleged, the Referee in Bankruptcy, sitting as a Special Master, on December 6, 1965, heard the proceedings and indicated that he would make a report to the judge. This report was filed by the Referee on December 15, 1966 (Tr: 115). The report of the Referee came on for hearing before the District Judge on January 26, 1967. The Appellant had filed objections to the confirmation of the Master's Report and moved to strike specific findings of fact and conclusions of law, predicated its request for relief on the contention that all issues in B-5696-Tuc. were moot by reason of the proceedings taken in B-5720-Tuc. (Tr: 130). The District Judge approved the Master's Report and consolidated B-5696-Tuc. with B-5720-Tuc. and referred the case to Hugh M. Caldwell as Referee and Special Master to, among other things, hear and determine and report on the issues raised by the pleadings in B-5696-Tuc. (Tr: 141). It is this action by the District Judge which is the basis of the appeal herein.

SPECIFICATION OF ERROR

I.

The court erred on January 23, 1967, in approving the involuntary petition initiated October 28, 1965, by the creditors in B-5696-Tuc. against The Lusk Corporation and directing that a date and hour for hearing be fixed pursuant to Section 161 of the Bankruptcy Act (11 U.S.C. 561) and directing that a hearing be had on the issues raised by the answers filed by any persons other than the Debtors to the involuntary petition filed in B-5696-Tuc. and in B-5720-Tuc. and in entering its formal order to like effect on January 26, 1967, in that the issues thereby set for hearing were moot for the reason that (1) all of the matters set for hearing were then res judicata by reason of the proceedings theretofore had in B-5720-Tuc. and (2) all of the matters set for hearing were then moot for the following reasons:

a. After the filing of the involuntary petition in B-5696-Tuc. under Section 126 of the Bankruptcy Act (11 U.S.C. 526) against The Lusk Corporation, said Debtor filed an answer admitting and alleging all of the allegations required to be made by a Debtor or by petitioning creditors under Section 130 of the Bankruptcy Act (11 U.S.C. 530) and denying the additional allegations required to be made by petitioning creditors under

Section 131 of that Act (11 U.S.C. 531). This made all of the issues then pending between the petitioning creditors and the Debtor moot. At that time, pursuant to Section 144 of the Bankruptcy Act (11 U.S.C. 544), there had been filed by this Appellant an answer challenging the allegations made by the petitioning creditors; this Appellant has not and did not challenge the allegations made by the Debtor, The Lusk Corporation. The answer filed by The Lusk Corporation rendered the issues between the petitioning creditors and this Appellant moot, and the Master then could have reported the state of the record to the judge, but on the contrary took the matter under advisement and continued the same for hearing. Therefore, he had accepted the referral to him of the voluntary petition covering the whole family of Lusk corporations in B-5720-Tuc. and acted thereon and thereby rendered the proceedings in B-5696-Tuc. moot, and at that time the court should have dismissed the proceedings in B-5696-Tuc.

b. After the approval by the judge in B-5720-Tuc. of the voluntary petition of the family of Lusk corporations, the Referee took no further action on the petition and answer filed in B-5696-Tuc. until the 15th day of December, 1966, at which time he filed a Special Master's Report; but in B-5720-Tuc.,

the Referee continued to conduct the proceedings necessary to the administration of the Debtors in reorganization, including the setting of a Section 161 hearing (11 U.S.C. 561) for the 4th day of January, 1966, at which hearing there were no objections filed and the Trustee appointed by the judge continued in office and administrated the affairs of the Debtors in the reorganization proceedings. No appeal from the approval of the petition appointing a Trustee entered by the judge in B-5720-Tuc. was taken, and the participation therein of all of the creditors constituted an abandonment of the proceedings in B-5696-Tuc. to such extent said proceedings had become moot, and the judge should have dismissed said proceedings when the record was made apparent to him by the report and recommendations of the Master.

c. In B-5720-Tuc., no answer was filed by any creditor under Section 144 of the Bankruptcy Act (11 U.S.C. 544) except for the answer filed by First Federal Savings and Loan Association challenging the good faith of the voluntary petition. The relief sought by that creditor (leave to foreclose several of its mortgages) has been granted, so no issues on the validity of the voluntary petition remain to be heard under Section 144, and the order approving the petition as properly filed has become

final so that all issues in B-5696-Tuc. are moot and the petition should have been dismissed by the judge.

d. The District Court acted beyond its jurisdiction in referring any issue raised by any pleadings in B-5696-Tuc. to the Referee for hearing, since all of the issues raised by the involuntary petition by the Debtor and any creditor in those proceedings have become moot by the action of the court in B-5720-Tuc. and all of such issues are immaterial since the determination thereof could serve no purpose, the family of Lusk corporations now being under a valid reorganization in B-5720-Tuc.

e. The court exceeded its jurisdiction on the 23rd day of January, 1967, and the 26th day of January, 1967, in consolidating B-5696-Tuc. with B-5720-Tuc. and approving the petition in B-5696-Tuc. as properly filed after having theretofore on November 4, 1965, approved the petition in B-5720-Tuc. as having been properly filed and conducted reorganization proceedings therein up to said January 23, 1967. The court further exceeded its jurisdiction by rendering the proceedings heretofore had in B-5720-Tuc. uncertain as to finality in that it thereby extended the time for creditors to answer in the consolidated proceedings up to and including the 23rd day of March, 1967, although in B-5720-Tuc. the time for creditors to answer the

voluntary petition filed by the family of Lusk corporations had expired on the 4th day of January, 1966 (the time set for the Section 161 hearing in B-5720-Tuc.), all of which rendered the proceedings in B-5696-Tuc. moot.

f. At the time the petition was filed by the creditors against The Lusk Corporation in B-5696-Tuc., it was presented to the judge who made no order pursuant to Section 141 of the Bankruptcy Act (11 U.S.C. 541) but referred the petition to the Referee as a Special Master to make findings and report to the judge. While this petition was pending before the Referee, The Lusk Corporation, The Lusk Corporation of Tucson, Inc., Broadway Construction Company of Tucson, Inc., The Lusk Corporation of Phoenix, Inc., Broadway Construction Company of Phoenix, Inc., and Construction Components, Inc. jointly filed a voluntary petition in B-5720-Tuc. for reorganization under Chapter X of the Bankruptcy Act. This petition was presented to the judge who approved it as properly filed in accordance with the provisions of Section 141 of the Bankruptcy Act (11 U.S.C. 541) and referred it to the Referee. The court by this action made all of the issues in B-5696-Tuc. moot.

PROPOSITIONS OF LAW

I.

Where the answer filed by a debtor to an involuntary petition in bankruptcy proceeding admits or sets forth affirmatively all of the allegations required to be made by a debtor seeking relief under Chapter X of the Bankruptcy Act, such answer eliminates the necessity for hearing any issue raised by the pleadings between the debtor and the petitioning creditors.

II.

Where an answer filed by a debtor to an involuntary petition alleges or admits all of the allegations required to be filed by Section 130 of the Bankruptcy Act (11 U.S.C. 530), it eliminates from the consideration of the court any issue required to be pleaded by petitioning creditors under Section 131 of the Bankruptcy Act (11 U.S.C. 531) and any issues thereunder existing at said time are rendered moot.

III.

Where two petitions are filed in the same District Court, one by petitioning creditors against a parent corporation asking a Chapter X reorganization of the parent corporation, and one in a separate proceeding by the parent corporation and its subsidiaries seeking a reorganization under Chapter X of the

Bankruptcy Act, and the second petition is approved as properly filed by the District Judge while the first petition is still pending for report by a Special Master; and under the petition which is approved, for approximately a year and a half thereafter the estate of the Debtor and its subsidiaries is administered by the Trustee under the control of the Referee, and all reports are made by the Referee acting as a Special Master, upon which reports the District Judge acts, the original petition filed by the petitioning creditors and all issues raised thereby have become moot.

IV.

When an issue becomes moot, a court will take no further proceedings on that issue.

V.

The court will not take proof on a moot question nor will it make any judicial determination thereon.

ARGUMENT

By the provision of Section 126 of the Bankruptcy Act (11 U.S.C. 526), a debtor, by complying with the provision of Section 130 (11 U.S.C. 530), may file a petition for reorganization under Chapter X of the Bankruptcy Act. Upon the filing of the petition by debtor, the judge shall enter an order approv-



ing the petition or dismissing it as provided by Section 142 of the Bankruptcy Act (11 U.S.C. 542). These proceedings are ex parte. However, notwithstanding the approval of the petition, by the provision of Section 137 of the Bankruptcy Act (11 U.S.C. 537) any creditor may controvert the allegations of the petition prior to the hearing called for by Section 161 of said Act (11 U.S.C. 561).

By the provision of Section 126 of the Bankruptcy Act (11 U.S.C. 526), creditors may file a petition against a debtor by complying with the provisions of Sections 130 and 131 (11 U.S.C. 530 and 531). Upon such filing, a subpoena shall issue to the debtor and be served as provided by Section 133 (11 U.S.C. 533). The debtor must answer within ten days pursuant to Section 136 (11 U.S.C. 536). During the same period and until the hearing provided for in Section 161 (11 U.S.C. 561), any creditor may answer. (The hearing provided for in Section 161 is to determine whether the trustee, if any, heretofore appointed shall continue in office and other administrative matters shall be continued.) By the provisions of Sections 142 and 143 (11 U.S.C. 542 and 543), issues raised by the answer, if any, of the debtor are for determination by the judge. If no material allegation of a creditors' petition is denied by the



Three (3) copies of Appellant's Opening Brief received this

27th day of July, 1967.

HALL, JONES, HANNAH, TRACHTA & BIRDSALL

By Richard T. Cusledge

Attorneys for Appellee
1010 Valley National Building
Tucson, Arizona

debtor, the judge shall enter an order approving the petition.

If a material allegation is controverted by the debtor, the judge shall determine the issue presented by the pleadings and either approve the petition or dismiss the proceedings.

A creditor need not wait for the hearing date set pursuant to the provisions in Section 161, but may appear within the ten-day period following the filing of a petition by the creditors and controvert the allegations of the petition as provided in Section 144 of the Bankruptcy Act (11 U.S.C. 544), and the judge shall determine the issues and approve the petition or dismiss the petition.

Section 144 directs that the judge shall determine "the issues presented by the pleadings" should a creditor, indenture trustee or stockholder controvert any of the material allegations of the involuntary petition filed by creditors of the debtor.

Sections 143 and 144 (11 U.S.C. 543 and 544) appear to be susceptible of a construction which will make them appear to be in conflict to some extent. However, the matter is not without court determination.

In Moore v. Linahan, et al, 117 F.2d 140, the Circuit Court of Appeals for the Second Circuit held without equivocation that a debtor was free to file an answer admitting the

creditors' allegations required by Section 130 (11 U.S.C. 530) and denying the allegations required by Section 131 (11 U.S.C. 531) although by the provisions of Section 128 (11 U.S.C. 528) such a debtor could not file a voluntary petition. The court went further and held that an answer admitting the allegations required by Section 130 did not constitute a voluntary petition but would permit the approval thereof where the answer did not controvert any of the material allegations of Section 130, although it expressly denied the allegation or allegations of Section 131. The court said at page 143:

For these reasons it seems to us at least doubtful that when, as here, the debtor chooses to pray for the approval of an involuntary petition, either creditor, "indenture trustee" or stockholder can press to decision the added allegation required by Section 131; that is, can vicariously assume the debtor's defence as to something against which it does not want protection and in which as such the creditor can have no interest. But if that is not true and if Section 137 must be read with strict literalness, certainly the occasions will be rare, when it will be of service for a debtor to file a voluntary petition, pending an involuntary, and so to short-circuit, so to say, such an opposition. That possibility, assuming that it exists, does not justify us in interpolating into Section 126 an exception contrary to the ordinary meaning of the words. For these reasons we think that the debtor's answer of February 23d cannot be regarded as a voluntary petition.

Following the decision in Moore v. Linahan, supra,

Hudson & Manhattan Railroad Company v. Stichman, 229 F.2d

616, came before the same Circuit Court of Appeals in a situa-

tion very similar to Moore v. Linahan. An involuntary petition for reorganization had been filed. The debtor in its answer admitted the allegations required by Section 130 (11 U.S.C. 530) and denied the act of bankruptcy alleged pursuant to the requirements of Section 131 (11 U.S.C. 531). There, the court pointed out that the debtor's answer could not be considered a voluntary petition, and in reviewing Moore v. Linahan stated:

* * * We pointed out there, however, that the requirement in Section 131, 11 U.S.C.A. Section 531, that an act of bankruptcy be alleged in an involuntary petition was for the protection of the debtor. We suggested that a creditor or shareholder should not be permitted to controvert the allegation of an act of bankruptcy if the debtor consents to the reorganization and does not choose to avail itself of such a defense. But see 6 Collier on Bankruptcy 1631-32. For the same reason, if the debtor consents to reorganization it may not at the same time raise an issue as to the existence of an act of bankruptcy. The only purpose of raising such an issue is to protect the debtor from an unnecessary reorganization. If it does not desire that protection, it cannot impose upon the court the necessity of a hearing on the issue. Judge Walsh was correct in his view that the debtor's answer rendered immaterial any issues relating to insolvency or acts of bankruptcy."

* * * We have already pointed out that when the debtor consented to reorganization and alleged the essentials of a voluntary petition, the issues relating to acts of bankruptcy and insolvency were removed from the case.

That court, noting that a shareholder had appeared in the case and challenged the petition, further commented:

* * * Of course the order of December 14 was not a final order conclusive against the shareholder who

answered under Section 137, 11 U.S.C.A. 537. Since his answer was timely filed he cannot be barred except by a final order determining the issues raised by his answer.

It will be observed, in light of the last quotation, that the decision left to be determined the question raised by the shareholder's answer which was timely filed pursuant to Section 137 (11 U.S.C. 537). Thereafter, the matter came before the District Court in In re Hudson & Manhattan Railroad Co., 138 F. Supp. 195, and Judge Walsh, following the Circuit Court decision in Hudson & Manhattan Railroad v. Stichman, supra, held at page 197:

Proofs of acts of bankruptcy are not required when the debtor, itself, petitions for reorganization, but only when the debtor controverts an involuntary petition. Even though the debtor's prayer was expressed by answer rather than petition, it was believed to have the same effect so far as reducing the issues necessary to be tried. The debtor's answer admitted the allegations necessary for a voluntary petition.

And on page 199, the court stated:

* * * The stockholder, now joined by the debtor, claims that the denials of insolvency and acts of bankruptcy framed material issues requiring hearing.

Having concluded that the petition of the creditors and answer of the debtor taken together left the proceeding with the same issues as though a voluntary petition had been filed the stockholder's answer was appraised accordingly. The allegations of acts of bankruptcy having been rendered immaterial by the debtor's pray-

er for reorganization, the stockholder's denial of those allegations was likewise held to be immaterial. His answer was given the same effect as though it had been filed after a voluntary petition by the debtor.

The stockholder had the right to put in issue those allegations of fact alleged by the petition which still remained material in the light of the debtor's own prayer for reorganization but he had no standing to compel the court to read the pleadings in disregard of the prayer of the debtor, any more than he could have compelled the court to disregard the voluntary quality of a petition which the debtor might have filed originally. An answer of a stockholder could not make involuntary, a proceeding which prior to its filing had, at least for the purpose at hand, acquired the characteristics of a voluntary one.

We thus come to the necessity of an analysis of the pleadings filed by the petitioning creditors, the Debtor, and the Answer and Motion to Dismiss of Appellant. The petition of the petitioning creditors makes the allegations required by Section 130 (11 U.S.C. 530), alleging, in addition to the jurisdictional facts, the facts showing need for relief and the status of any plan of reorganization. The petition further alleged that there were no pending bankruptcy proceedings, and that while the assets of the Debtor were unknown to the petitioners they were informed and believed that the amount of said assets was an amount less than the liabilities of the corporation, and that the debtor and its subsidiaries, all of whom were named, were

unable to pay their debts as they matured. The petition then met the requirements of Section 131 (11 U.S.C. 531) by alleging that the corporation had committed an act of bankruptcy within four months before the filing of the petition filed by the creditors, the act of bankruptcy pleaded being the second act of bankruptcy referred to in Section 3.a.(2) of the Bankruptcy Act (11 U.S.C. 21), to-wit: "made or suffered a preferential transfer as defined in subdivision a. of section 60 of this Act" and in general terms described the preferential transfer so as to come within the meaning of Section 60.a.(1). Lusk answered the petition and admitted the allegations thereof, except it stated that it did not know if its assets exceeded its liabilities because of the economic depression existing around Tucson depressing the value of land, its major asset, and denied the allegations required by Section 131 (11 U.S.C. 531). Lusk admitted in no uncertain language that the Debtor and all of its subsidiaries were unable to pay their debts as they matured and expressly denied that it had committed the act of bankruptcy pleaded. The Special Master, in making his review to the court, found as a fact no material issue and that the answer constituted a consent on Lusk's part to the approval of the creditors' petition.

A Motion to Dismiss and Answer was filed by Appellant in the proceeding. The Motion to Dismiss attacked the creditors' petition for failure to meet the requirements of Section 130 of the Bankruptcy Act (11 U.S.C. 530) and further attacked the good faith of the creditors' petition. It also raised the legal status of the proceedings by reason of the filing by the Debtor, together with its subsidiaries, of a petition seeking a plan of reorganization. The answer also challenged the good faith of the creditors on the basis that the petitioning creditors had no plan of reorganization to propose and denied that there had been an act of bankruptcy as alleged in the creditors' petition. From an analysis of the pleadings, it thus appears that the issues raised by the answer of Appellant are now immaterial in the light of the contents of the answer filed by The Lusk Corporation, except as to those issues which could be raised had a voluntary petition been filed by Lusk. Those issues which remain in Appellant's answer and which are not disposed of by the admissions of Lusk in its answer, and which issues are permitted to be raised by any creditor if timely filed under Section 137 (11 U.S.C. 537), are (1) the denial of the desire of petitioners that a plan be effected and (2) the denial of good faith of the petitioning creditors.



The issues thus raised should not be set for hearing by reason of the action taken in B-5720-Tuc. In that proceeding, the Debtor and some of its subsidiaries, each of which is a separate entity, joined together and filed a petition seeking reorganization under Chapter X of the Bankruptcy Act. The court approved the petition as properly filed, appointed a Trustee and ever since has proceeded to administer the affairs of all of the debtors therein. No appeal has been taken from this action of the court and it is now too late to appeal. In In re Hudson & Manhattan Railroad Company, 138 F. Supp. 195, 199, the court stated:

The petition was thus approved without a hearing. As between the petitioning creditors and the debtor this approval of the petition was a final determination. The debtor did not appeal. The time to appeal has expired. Proof of an act of bankruptcy not being a jurisdictional fact necessary to the power to hear the case, but at most a fact necessary to the relief granted, the debtor's only remedy was by appeal. It could not attack this determination collaterally in his proceeding on the stockholder's answer.

This failure to appeal should be construed to constitute an abandonment by the petitioning creditors of their involuntary petition since they took nothing from the order approving the petition in B-5720-Tuc. However, should the court be of the opinion that the petition filed in B-5720-Tuc. is but an amendment

or supplemental answer to the petitioning creditors' pleading in B-5696-Tuc., it is submitted that it is such an amendment of the pleadings in the action which under Rule 15 of the Federal Rules of Civil Procedure constitutes a new cause of action and does not relate back within the provisions of 15.c. by reason of the joinder of the additional parties. To further add to the confusion, the petitioning creditors themselves amended their petition on or about April 4, 1966, by adding a new group of petitioners, and it is believed this also constitutes a new cause of action, and, again, the petitioning creditors' petition does not relate back but constitutes an amendment sufficient to start the time running with the date of the amendment.

There would certainly be no purpose in attempting to dispose of the allegations of a preference at this stage of the proceedings. The mere fact that a preference may have been given does not render the preferential transfer void. The requirement of Section 60.b. (1) of the Bankruptcy Act (11 U.S.C. 96) that the transferee had reasonable cause to believe the debtor to be insolvent must be met.

The court's attention is also directed to In re Equity Company of America, 115 F.2d 570, and particularly to the language of Judge Lindley appearing on page 572 thereof, to-wit:

* * * It matters little that when a creditor has instituted reorganization proceedings his petition is not in the greatest of detail, if the debtor shortly later consents to the relief prayed and the evidence supports the allegations of the petition.

As pointed out in Duggan v. Sansberry, 327 U.S. 499, the District Court before whom the proceedings are filed, having approved the petition as properly filed in B-3720-Tuc., had complete jurisdiction to proceed with the entire reorganization proceeding, and the action of the court was res judicata on all of the parties, subject, of course, to their right to appeal.

As pointed out in Grubbs v. Pettit, 282 F.2d 557, the burden is upon the petitioner to demonstrate that the petition has been filed in good faith. The District Court's decision as to whether a given petition has been filed in good faith is a finding that will not be set aside unless clearly erroneous.

In the instant case, creditor and debtor alike have accepted the administration of the debtor's business and the reorganization proceedings taken by the court in B-5720-Tuc., and there appears no substantial reason to consider the issues raised by the pleadings in B-5696-Tuc. as anything but moot, and the action of the court directing that there be further hearings and testimony of those issues should be reversed and set aside.

When a case has become moot, the court will not continue the proceedings. Under such circumstances, the rule stated in Industrial Development Company of Little Rock v. Thompson, 231 F.2d. 825, is applicable, to-wit:

Where controversy on appeal had become moot, reviewing court could dismiss appeal, vacate judgment, and direct that complaint be dismissed as moot.

The general principle of law appearing in 1 C.J.S., Actions, Section 17.d. is:

A case, originally presenting a controversy, may become moot by a decision of the court, or by acts of the parties or other causes, occurring after the commencement of the action, causing it to lose its controversial character.

This principle has been adopted in United States v. Alaska S. S. Co., 253 U.S. 113, 64 L.Ed. 808, 40 S.C. 448, wherein the court stated:

* * * Where by an act of the parties, or a subsequent law, the existing controversy has come to an end, the case becomes moot and should be treated accordingly.

Cause B-5696-Tuc. having become moot, the reviewing court should direct that it be dismissed.

Respectfully submitted.

LESHER, SCRUGGS, RUCKER, KIMBLE & LINDAMOOD

By 

Attorneys for Appellant
3773 East Broadway
Tucson, Arizona

CERTIFICATE

I certify that, in connection with the preparation of this Brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

A handwritten signature in blue ink, appearing to read "E. F. Rucker", is written over a horizontal line.

E. F. Rucker



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UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

HOTPOINT DIVISION OF GENERAL
ELECTRIC COMPANY, a New York
corporation,

Appellant,

vs.

No. 21812

CHARLES D. McCARTY, as Trustee
in Bankruptcy for THE LUSK
CORPORATION, et al.,

Appellee.

APPELLEE'S BRIEF

HALL, JONES, HANNAH, TRACHTA & BIRDSALL
1010 Valley National Building
Tucson, Arizona 85701

and

CHARLES D. McCARTY
1110 Transamerica Building
Tucson, Arizona 85701

Attorneys for Appellee

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APPELLEE'S BRIEF

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STATEMENT OF THE CASE

We believe that a chronological statement of the case will assist the Court and for this reason appellant's statement of the case is supplemented as follows. References to the transcript will be referred to as "Tr." plus the page number, and unless otherwise specified refer to Volume I of the transcript.

Following in chronological order are the filings and matters which are deemed material for purposes of this appeal:

October 28, 1965 - Involuntary petition under Chapter X, as to The Lusk Corporation, filed by three creditors (Tr. 4).

October 28, 1965 - Reference order endorsed on the involuntary petition by Judge Walsh, referring matters to the Referee in Bankruptcy as Special Master (Tr. 4).

November 4, 1965 - Voluntary petition filed under Chapter X as to The Lusk Corporation and five subsidiary corporations (Tr. 81).

November 5, 1965 - Order approving voluntary petition as to The Lusk Corporation and its named subsidiaries (Tr. 86).

November 5, 1965 - Order appointing A.C. Simon Trustee (Tr. 88).

November 5, 1965 - Answer of The Lusk Corporation to

the involuntary petition (Tr. 19).

November 5, 1965 - Motion of General Electric Company to dismiss the involuntary petition (Tr. 24).

November 5, 1965 - Answer of General Electric Company, as creditor, to the involuntary petition (Tr. 26).

December 6, 1965 - Motion of A.C. Simon, as Trustee, to intervene in cause B-5696 (Tr. 45).

December 6, 1965 - Motion of A.C. Simon, as Trustee, for an order approving the involuntary petition (Tr. 46).

December 6, 1965 - Motion of A.C. Simon, as Trustee, to consolidate cause B-5696 (the involuntary petition) with cause B-5720 (the voluntary petition) (Tr. 48).

December 6, 1965 - Motion of petitioning creditors on involuntary petition for an order approving involuntary petition (Tr. 33).

December 8, 1965 - Objection of General Electric Company to consolidation of causes B-5696 and B-5720 (Tr. 104).

January 3, 1966 - Answer of First Federal Savings and Loan Association of Phoenix, as creditor, to involuntary petition (Tr. 49).

January 3, 1966 - Answer of First Federal Savings and Loan Association of Phoenix, as creditor, to voluntary petition (Tr. 106).



January 4, 1966 - Hearing on the retention of A.C. Simon as Trustee pursuant to Sec. 161 of the Bankruptcy Act (Tr. 110).

March 24, 1966 - Motion of petitioning creditors to amend petition to add additional creditors as petitioners (Tr. 55).

June 15, 1966 - Order granting motion of petitioning creditors to amend involuntary petition (Tr. 67).

December 15, 1966 - Report of Special Master on pending proceedings (Tr. 115).

January 19, 1967 - Motion of petitioning creditors to modify the order approving the voluntary petition and asserting an answer under Sec. 144 of the Bankruptcy Act (Tr. 128).

January 23, 1967 - Motion of General Electric Company to dismiss the involuntary petition, and objections of General Electric Company to findings of the Special Master numbered 9 and 14 and to conclusions of law of the Special Master numbered VII and XIV (Tr. 130).

January 23, 1967 - Minute entry adopting the report of the Special Master, appointing the Trustee, and directing that the Special Master set pending matters for hearing (Tr. 149).

According to the report of the Special Master

(Tr. 116-117), the voluntary petition was presented to the Judge for consideration without notice to the petitioning creditors who had previously filed the involuntary petition, by a group of attorneys for parties in interest, including the attorney for the appellant herein. The Referee in Bankruptcy was also present at the time the petition was presented to the Judge for approval. At that time the Judge was given the undertaking of counsel that if the petition were to be approved by the Court such approval would not prejudice the rights of the petitioners under the involuntary petition, and the voluntary petition was approved with this reservation by the Court. There has never been any objection or exception to this recital in the report of the Special Master.

The motion of General Electric Company to dismiss, the answer of General Electric Company, and the answers filed by First Federal Savings and Loan Association of Phoenix were excluded from consideration by the Special Master, who recommended that these matters be set for hearing after the approval of the involuntary petition (Tr. 126-127).

As pointed out above, these findings were adopted by the Court in the minute entry of January 23, 1967 (Tr. 149). The involuntary petition was approved and the

Special Master was instructed to proceed with hearings on the motion to dismiss and answer of General Electric Company and any other answers which had been properly filed or which would be properly filed.

July 2, 1965, The Lusk Corporation mortgaged to General Electric Company a portion of its assets to secure a debt to General Electric Company in the amount of \$1,500,000. Finding number 9 of the Special Master (Tr. 122). This finding was subject to a motion to strike filed by General Electric Company (Tr.130). The basis for this motion is obscure in the light of the fact that the motion to dismiss filed by General Electric Company (Tr. 24) contains an allegation of substantially the same facts in its first paragraph. The significance of the dates of the petitions herein is readily apparent. The mortgage was given approximately four days less than four months prior to the filing of the involuntary petition and approximately three days more than four months prior to the filing of the voluntary petition. It would seem fairly evident that the voluntary petition was filed in an effort to put this transfer beyond the reach of a trustee. This conclusion seems inescapable in the light of the answer filed by the debtor to the involuntary petition, wherein it readily admits the necessity of reorganization and the fact of its inability to pay its debts.

The statement of fact embodied in Specification of Error I(c), page 9 of appellant's brief, is totally unsupported in the record. Appellant departs from the record in making this factual statement.

APPELLEE'S PROPOSITIONS OF LAW

1. All parties whose interests would be affected by a reversal on appeal must be made parties to the appeal.

2. Where an answer has been filed by a creditor pursuant to Sec. 137 of the Bankruptcy Act, the prior approval of a voluntary petition is not conclusive and the question of approval remains such until final determination of the issues raised by the answer pursuant to Sec. 144 of the Bankruptcy Act.

3. A creditor is without standing to appeal from an order of approval entered under Sec. 142 of the Bankruptcy Act.

4. A creditor is without standing to appeal from an order approving a Chapter X petition entered under Sec. 143 of the Bankruptcy Act unless the creditors, debtor, indenture trustees and stockholders have been given notice of hearing as provided in Sec. 145, and the issues have been finally determined.

5. An interlocutory order of approval of a



voluntary petition under Chapter X pursuant to Sec. 141 of the Bankruptcy Act is without prejudice to an involuntary petition previously filed against the same debtor until final determination of issues raised in the answers of creditors and others filed pursuant to Sec. 144 of the Bankruptcy Act.

6. The party asserting a position in a controversy designed to procure a ruling by the court and which does, in fact, lead to such ruling, cannot thereafter be heard to assert an inconsistent position where the rights of other parties not given an opportunity to be heard will be prejudiced.

Argument on Proposition of Law No. 1

The rule stated in appellee's Proposition of Law No. 1 is a simple corollary to the proposition that no court has jurisdiction to determine the rights of a party who is not before the court. The real meat of the appeal here is the order approving the involuntary petition since all of the other matters appealed from are orders in furtherance of the order approving the involuntary petition. The petition was filed by three petitioning creditors who procured the relief sought and appellant would now have the court reverse the case so as to deny relief to the petitioners without naming the petitioners as appellees herein.

The rule stated in Proposition of Law No. 1 is textually supported in the following texts:

4 Am.Jur. 2d p.772, Sec. 273. "All parties in favor of whom judgment was rendered and who would be affected by its reversal must be made appellees or defendants in error."

4 C.J.S. p.860, Sec. 398. "All parties whose interests will be affected by a reversal or modification of the judgment or decree below, as well as all interested coparties of the appellant or plaintiff in error who are not made coappellants or coplaintiffs in error, must be made appellees or respondents in error."

88 A.L.R. 420. "There is no dissent from the proposition that an adverse party, within the meaning of a statute requiring notice of appeal to be served on one who falls within that category in order to give the reviewing court jurisdiction to hear the appeal, is a party to the action whose interests in the subject matter of the action, it appears from the record, might subsequently be adversely affected by, or in the event of, a modification or reversal of the judgment appealed from."

We have not been able to find any federal case which is particularly helpful. Most of the federal cases arise under the failure to join a codefendant on appeal where

judgment went against both defendants below under the prior federal procedure requiring a summons and severance. However, the rule receives some left-handed support in the annotation at 50 L.Ed. 723, where it points out that, "parties whose legal interests will not be affected by the success or failure of the appellate proceedings need not join therein."

It is respectfully submitted that this Court is without jurisdiction to reverse the order approving the petition of the petitioning creditors where the petitioners have not been brought before this Court as parties to the appeal.

Argument on Proposition of Law No. 2

Pursuant to Sec. 141 of the Bankruptcy Act, the Judge, on being handed a voluntary petition under Chapter X, is required to examine the petition to determine if it complies with the requirements of Chapter X. If it does so and it appears on the face of the petition that it was filed in good faith, it becomes the duty of the Judge to approve the petition. There is no requirement whatsoever for notice, and the creditors and others are relegated to the relief afforded them by Secs. 137 and 144 of the Act, which permit the filing of an answer by a creditor at any time prior to the time fixed for the hearing under Sec. 161 of the Act. In this case an answer was filed by First



Federal Savings and Loan Association of Phoenix generally controverting the allegations of the voluntary petition and specifically controverting the good faith of the filing (Tr. 106). In addition, prior to the report of the Special Master the petitioning creditors filed a motion for the approval of the involuntary petition embodying an answer under Sec. 144 of the Act. This answer was accepted by the Special Master, who included it in his recommendation for a further hearing on the matter (Tr. 33 and Tr. 127). The Trustee had moved for the approval of the involuntary petition December 8, 1965 (Tr. 46). The Trustee is not authorized by the law to file an answer.

If appellant's argument is accepted and carried to its conclusion it would mean that notwithstanding the duty of the court to inquire into the issues raised by the answers of creditors under Sec. 144 and the motions for approval, the creditors' petition must be dismissed. This, of course, is nonsense. The issue of the good faith of the voluntary petition remained before the court after the approval of the voluntary petition and will remain until the answers have been disposed of. Actually, in this case there is a strong likelihood of a finding of bad faith with respect to the filing of the voluntary petition in the light of the mandate of Sec. 146(4)

which provides that a petition shall be deemed to have been filed not in good faith if a prior proceeding is pending which would serve best the interests of creditors and stockholders. If, upon the final determination of the issues as required by the Judge, the Judge should conclude that the voluntary petition was not filed in good faith, he would be required to dismiss the petition pursuant to Sec. 144, which, if appellant's position were adopted, would leave all petitions dismissed and the matter lying in a state of unbelievable chaos.

It is respectfully submitted that there is no merit in the suggestion that the failure of anyone to appeal the approval of the voluntary petition created any prejudice to the right of any creditor to appear at the hearing provided for in Sec. 144 of the Bankruptcy Act and controvert the good faith of the petition. A creditor or trustee is not a party to such approval and is without standing to appeal. The fact that the order of approval of a voluntary petition is not conclusive and that the final approval may be required to merit a hearing under Sec. 144 and a second approval is pointed out by the Supreme Court in Note to Duggan v. Sansberry, 327 U.S. 499 at 506, 90 L.Ed. 809, 66 Sup.Ct. 657. (Note 11)

Argument on Proposition of Law No. 3

Admittedly there is some room for conjecture as to whether the approval of the involuntary petition was an approval pursuant to Sec. 142 of the Act or Sec. 143 of the Act. It is our point in arguing Propositions of Law Nos. 3 and 4 to show that it makes no difference whether the approval was made pursuant to Sec. 142 or Sec. 143 unless there was a hearing under Sec. 143 of the Act, with notice to the debtor, creditors, stockholders and indenture trustees as required by Sec. 145, so that a determination under Sec. 143 could become "final" as that term is used in Sec. 145 of the Act. No such notice was given in this case and accordingly if, in fact, the approval was under Sec. 143 of the Act, it was not final within the meaning of Sec. 145. There can be no question that this was the express intent of both the Special Master and the Judge who, in their findings and order with respect to the approval of the involuntary petition, specifically reserved for determination under Sec. 144 the issues raised by the motion of General Electric Company to dismiss and the issues raised by all answers.

Sec. 142 provides that if the debtor files a non-controversial answer it is the duty of the court to approve the involuntary petition if it complies with

Chapter X and appears to have been filed in good faith. We would like to urge the Court to avoid as unnecessary the issue as to whether the answer filed by the debtor herein was a noncontroversial answer envisioned by Sec. 142 of the Act. We intend to develop the proposition that it makes no difference whether the approval was made pursuant to Sec. 142 or Sec. 143 as far as the rights of creditors were concerned. Whether or not the answer was a noncontroversial answer may be of considerable importance in subsequent proceedings herein and we do not believe that the Court should make any determination because such a determination is wholly unnecessary.

There is some divergence between the cases and the texts with respect to what may be considered to be a noncontroversial answer. Assuming arguendo in support of Proposition of Law No. 2 that the Special Master and Court treated the answer as a noncontroversial answer under Sec. 142, it was the duty of the Judge to approve the involuntary petition. There is no provision whatsoever for creditor participation in this determination by the Judge. In precisely the same manner that a creditor may pursue his remedy upon the approval of a voluntary petition, any creditor who believes himself to be aggrieved by the approval of an involuntary petition may file an answer

pursuant to Sec. 137 of the Act and have a hearing on his answer as provided in Sec. 144. A creditor or trustee is not a party to such approval and has no standing to appeal from the order of the Court. The statute makes it mandatory for the Judge to approve the petition if it complies with the Act and was filed in good faith, and the creditor may thereafter controvert if he wishes. The creditor first becomes a party to the proceedings by filing an answer under Sec. 137 and until his answer has been disposed of there is nothing for him to appeal from. It is respectfully submitted that the appellant is and was no party to the action of the Court if taken pursuant to Sec. 142 of the Act and that there was pending on the date of the order appealed from the issues raised by the answer and motion of General Electric Company. There had been no ruling at the time of this appeal on any matter in which General Electric Company was a party. See, also, Note 12 to Duggan v. Sansberry, 327 U.S. 499, 90 L.Ed. 809, 66 Sup.Ct. 657.

Argument on Proposition of Law No. 4

Again we would like to urge the Court to avoid the question of whether or not the answer of the debtor was a noncontroversial answer. It is not necessary to the decision on this appeal and that issue may become important in the future developments of this case.

Assuming arguendo that the action of the Special Master and Judge in approving the involuntary petition was made pursuant to Sec. 143 of the Act, again the creditors of the company are no party to that action of the Court unless specifically made so by notice to the debtor, creditors, indenture trustees and stockholders pursuant to Sec. 145 of the Act. No such notice was given. In the case of a controversial answer it is the duty of the Court to resolve that controversy between the petitioning creditors and the answering debtor. This hearing as between petitioning creditors and the debtor may be summary, as pointed out in Duggan v. Sansberry, 327 U.S. 499 at 507, 90 L.Ed. 809, 66 Sup.Ct. 657. It is true that the creditors can be brought into the hearing at that time upon notice under Sec. 145 of the Act. This, however, was not done. This notice not having been given, the creditor is in precisely the same position that he is in had the answer been noncontroversial. He is no party to the action of the Court in approving the involuntary petition and becomes a party in the matter of the validity of the petition by filing an answer pursuant to Sec. 137 and taking the matter to trial under Sec. 144. See Note 12 to Duggan v. Sansberry, 327 U.S. 499 at 507, 90 L.Ed. 809, 66 Sup.Ct. 657.



There can be no question that if the approval was in fact under Sec. 143 of the Act it was not a final determination as that term is used in Sec. 145 since no notice was given and since both the Special Master and the District Judge specifically reserved for hearing and determination the issues raised by any answers theretofore or thereafter filed under Sec. 137 of the Act.

Professor John Gerdes, in his article, Corporate Reorganizations: Changes Effected by Chapter X of the Bankruptcy Act, 52 Harvard Law Review 1 at p.8, points out that the only sensible interpretation of the term "final determination" as used in Sec. 145 of the Act is a determination of the issues raised by whatever answers are filed under Sec. 137 of the Act and taken to trial under Sec. 144. Here, again, the appellant seeks to appeal from an order of the District Court to which it was no party, where its plain remedy was the filing of an answer, which it did file and which at the time of this appeal had not been determined.

Appellant seems to suggest at page 15, second paragraph, of the opening brief, that the Court is under some duty to hear a controverting creditor's answer before approval of a petition. The Court has no such duty. The obvious course for the Court is to wait for the time to



answer to expire pursuant to Sec. 137 and have one hearing on all answers. This is the procedure recommended by the writers. 6 Collier on Bankruptcy (14th Ed) p. 1017; John Gerdes, 52 Harvard Law Review 1 at pp. 7, 8. See, also, Notes 11 and 12 to Duggan v. Sansberry, 327 U.S. 499, 90 L.Ed. 809, 66 Sup.Ct. 657.

Argument on Proposition of Law No. 5

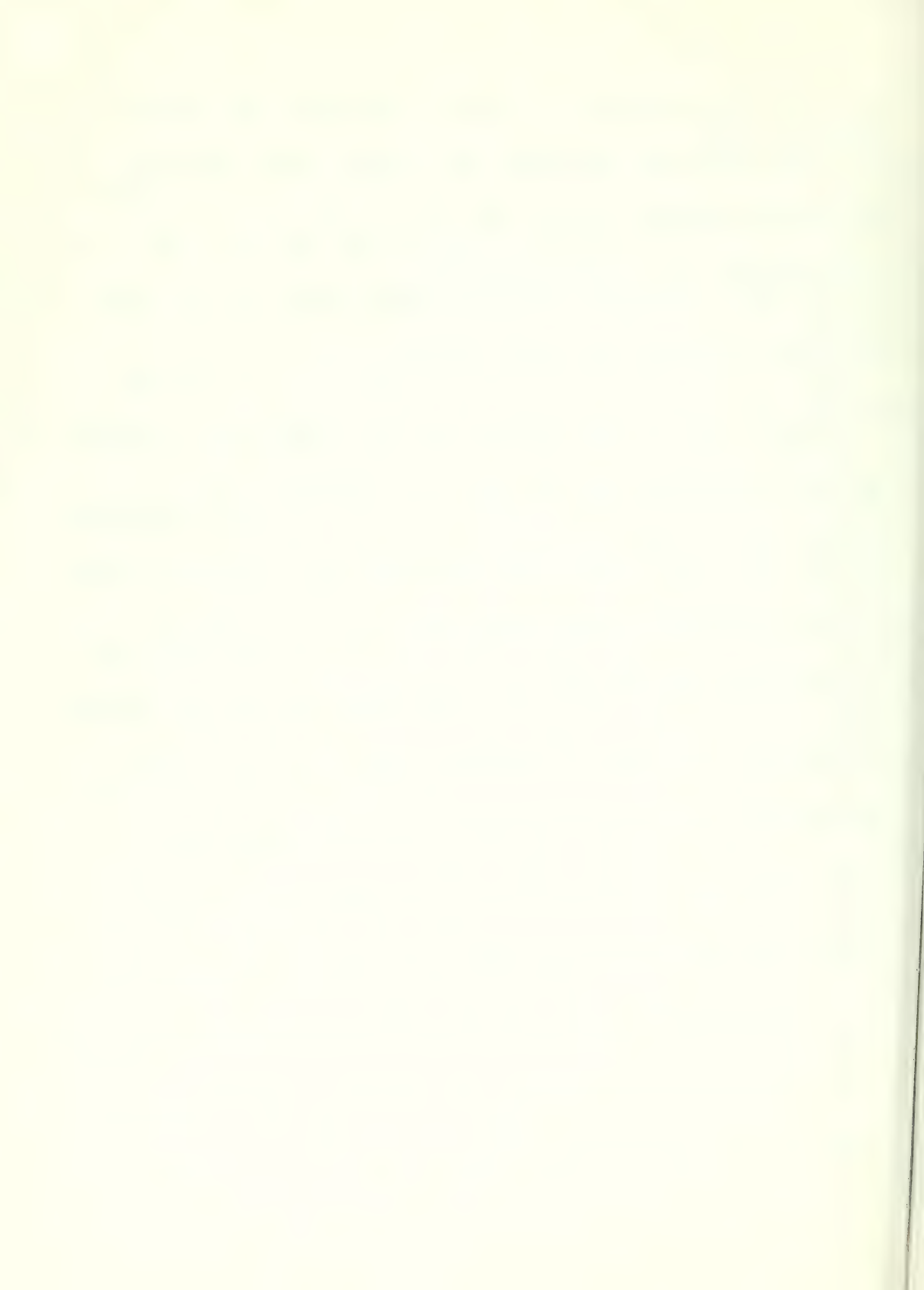
We will confess a total inability to see what comfort appellant finds in Moore v. Linahan, 117 F.2d 140, and Hudson & Manhattan R.R. v. Stichman, 229 F.2d 616, cited with such frequency in appellant's brief. The dicta in both cases (neither case involving a situation in which two Chapter X petitions had been filed as to the same debtor) strongly support the position that the voluntary petition was improperly filed and if anything in the case ever was moot it was the voluntary petition.

It is a strong temptation to suggest to the Court that the inhibition contained in Sec. 126 as to the filing of a Chapter X petition where another Chapter X petition is pending is jurisdictional in nature. However, we make no such argument and urge that the Court avoid this jurisdictional question because it is not now squarely presented to the Court and it will never be presented unless and until there is a final approval of the

voluntary petition after a hearing under Sec. 144 of the Act. Thus far there has been only the ex parte approval provided for in Sec. 141 of the Act, which, as the Supreme Court pointed out in Duggan v. Sansberry, 327 U.S. 499, 90 L.Ed. 809, 66 Sup.Ct. 657, is inconclusive and to which, as we have pointed out in the argument on Proposition of Law No. 2, the creditors and the trustee are not parties.

Judge Hand, in his opinion in the Linahan case, pointed out the possibility of the use of a voluntary petition to "short circuit" an involuntary petition. See the discussion at 117 Fed.2d at p.143 under headnotes 2,3. This situation, which Judge Hand at that early time had difficulty in envisioning, has materialized in this case. The voluntary petition was filed. From the cold record we have no trouble in gleaning an intent to promote a \$1,500,000 preference which may be voidable into an unassailable position by the lapse of four months. This pinpoints the danger of a jurisdictional discussion as to the meaning of Sec. 126 where the question is not squarely presented to the Court.

If on the Sec. 144 hearing on the voluntary petition the Court finds that it was filed in bad faith and dismisses it, that will be the end of it. Only if the Court finally approves it will the jurisdictional question be presented. It is respectfully submitted that there is not a word in



either of the cases so heavily relied upon by appellant supporting appellant's position.

Argument on Proposition of Law No. 6

The proposition suggested to the Court here is that of equitable estoppel. A good textual discussion of this principle may be found at 28 Am.Jur.2d, Para. 28, pp. 269, et seq. The United States Supreme Court has succinctly stated the rule in Morgan v. Chicago & A. R.R. Co., 96 U.S. 716, 24 L.Ed. 743, as follows:

The appellee insists that the record discloses a case of estoppel in pais, and that the appellant is thereby barred from maintaining the claim which he seeks to enforce in this litigation. The principle is an important one in the administration of the law. It not unfrequently gives triumph to right and justice where nothing else could save them from defeat. It proceeds upon the ground that he who has been silent as to his alleged rights when he ought in good faith to have spoken, shall not be heard to speak when he ought to be silent. Bk. v. Lee, 13 Pet., 107.

He is not permitted to deny a state of things which by his culpable silence or misrepresentations he had led another to believe existed, and who has acted accordingly upon that belief. The doctrine always presupposes error on one side and fault or fraud upon the other, and some defect of which it would be inequitable for the party against whom the doctrine is asserted to take advantage. Merch. Bk. v. St. Bk., 10 Wall., 604, 19 L. ed., 1008.

See, also, Dickerson v. Colgrove, 100 U.S. 478, 25

L.Ed. 618, and Leather Manufacturers National Bank v. Morgan, 117 U.S. 96, 29 L.Ed. 811, 6 Sup.Ct. 657. In the latter

case the doctrine was extended to negligent conduct. In this case the report of the Special Master (Tr. 116-117) recites that the voluntary petition was presented to the Judge in the presence of the Referee in Bankruptcy and counsel for various parties including appellant herein. At that time there was an undertaking by counsel that the approval of the voluntary petition would be without prejudice to those claiming under the involuntary petition and that the voluntary petition was approved with this reservation by the Court. The report further recites that the ink was hardly dry on the order of approval when appellant filed its motion to dismiss the involuntary petition upon the ground that it had been made moot by the approval of the voluntary petition (Tr. 24). It is respectfully submitted that no party can rely upon this kind of conduct to prejudice the rights of those not in attendance and who had no opportunity to be heard.

SUMMARY OF ARGUMENT

The position which appellee advances may be briefly summarized as follows:

1. The Court is without jurisdiction to hear the appeal because appellant has failed to bring indispensable parties before this Court on appeal.

2. The approval of an involuntary petition is not conclusive and a creditor becomes a party to such approval by filing an answer under Sec. 137 of the Act and trying the issues under Sec. 144 of the Act. This argument is designed to dispel the assertion that the failure to appeal the order of approval of the involuntary petition prejudices anyone.

3. A creditor is no party to an approval of an involuntary petition pursuant to Sec. 142 of the Bankruptcy Act and cannot appeal until he has become a party by filing an answer pursuant to Sec. 137 and litigating the issue pursuant to Sec. 144.

4. A creditor is not a party to the approval of an involuntary petition pursuant to Sec. 143 of the Act and becomes a party by filing an answer pursuant to Sec. 137 of the Act and trying the issues pursuant to Sec. 144. Both this and the latter point are designed to show that the appeal herein is premature and that appellant has no standing to file this appeal.

5. An approval under Sec. 143 of the Act is not binding on a creditor unless the notice specified in Sec. 145 has been given. Such notice was not given in this case.

6. The filing of a later voluntary petition can have

no affect on the pendency of an earlier Chapter X petition.

7. Appellant has been guilty of either conduct or silence which estops appellant from asserting the approval of the voluntary petition as any prejudice to the rights of the petitioning creditors on the involuntary petition.

Respectfully submitted,

HALL, JONES, HANNAH, TRACHTA & BIRDSALL
1010 Valley National Building
Tucson, Arizona 85701

and

CHARLES D. McCARTY
1110 Transamerica Building
Tucson, Arizona 85701

By

Charles D. McCarty
Charles D. McCarty

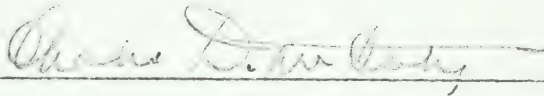
Attorneys for Appellee

I certify that in connection with the preparation of this brief I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Charles D. McCarty
Charles D. McCarty
Attorney for Appellee

CERTIFICATE OF SERVICE

I hereby certify that on the 20th day of December, 1967, I served three (3) copies of the foregoing Appellee's Brief upon counsel for the appellant, by mail, postage prepaid.

A handwritten signature in cursive script, reading "Charles D. McCarty", is written over a horizontal line.

Charles D. McCarty
1110 Transamerica Building
Tucson, Arizona
Attorney for Appellee



IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

OTPOINT DIVISION OF GENERAL
ELECTRIC COMPANY, a New York
orporation,

Appellant,

vs.

NO. 21812

HARLES D. McCARTY, as
rustee in Bankruptcy for
HE LUSK CORPORATION, et al,

Appellee.

FILED

FEB 5 1968

APPELLANT'S REPLY BRIEF

WM. B. LUCK, CLERK

ESHER, SCRUGGS, RUCKER, KIMBLE & LINDAMOOD
773 East Broadway
tucson, Arizona
ttorneys for Appellant

RECEIVED AND FILED this _____ day of _____,
1968.

JUDGE, UNITED STATES COURT OF APPEALS
FOR THE NINTH DISTRICT

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IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

HOTPOINT DIVISION OF GENERAL
ELECTRIC COMPANY, a New York
corporation,

Appellant,

vs.

NO. 21812

CHARLES D. McCARTY, as Trustees
in Bankruptcy for THE LUSK COR-
PORATION, et al,

Appellee.

APPELLANT'S REPLY BRIEF

Heretofore the documents which each party considers appropro to his particular position have been described in the briefs filed with the court. For convenience in considering this brief, again the documents and dates which are considered material to this argument as to major parts thereof are again set forth as follows:

Oct 28, 1965	Petition by creditors against the debtor The Lusk Corporation in B-5696 under Chapter X of the Bankruptcy Act (Tr: 1)
Oct 28, 1965	Order of reference to Referee-Special Master endorsed on bottom of first page of petition of creditors in B-5696 (Tr: 1)
Oct 28, 1965	Temporary Restraining order entered in B-5696 restraining suits, garnishments, sheriffs, etc. issued on petition of creditors in B-5696 (Tr: 17)
Nov 4, 1965	Answer of The Lusk Corporation and <u>subsidiaries</u> for reorganization under <u>Chapter X</u> of the Bankruptcy Act (Tr: 81) B-5720
Nov 5, 1965	Nov 5, 1965 order approving petition Lusk Corporation and subsidiaries B-5720 as complying with provisions of Chapter X of the Bankruptcy Act and as having been filed in good faith. (Tr: 86)
Nov 5, 1965	Order appointing Trustee in B-5720 Lusk Corporation and subsidiaries (Tr: 88)

Nov 17, 1965	Order amending order appointing trustee Lusk Corporation and subsidiaries (B-5720) and fixing time for hearing under 161 of the Bankruptcy Act (U.S.C. 561) (Tr: 93)
Mar 21, 1966	Motion of petitioning creditors to amend original creditors petition B-5696, adding new parties and new claims for Chapter X proceedings (Tr: 42) together with amended petition (Tr: 57)
June 7, 1966	Order allowing amendment to original petition B-5696 (Tr: 66)
Dec 15, 1966	Report and recommendations of referee-special Master on Involuntary petition (B-5696; B-5720) (Tr: 115)
Jan 26, 1967	Order approving petition and appointing trustee B-5696 The Lusk Corporation. (Tr: 69) and setting 161 hearing Mar 23, 1967, and approving involuntary petition as complying with Chapter X of the Bankruptcy Act and as having been filed in good faith
Jan 26, 1967	Order referring B-5696 and B-5720 to Referee-Special Master to hear issues raised by answers filed in B-5696 (Tr: 159)

As used herein Tr: designates transcript of record filed with the Clerk of the Circuit Court of Appeals and Rt: indicates Reporter's Transcript filed with said Clerk as part of the record on appeal in this case.

In response to Appellee's Proposition of Law No. I, appellant submits that the procedure for taking an appeal is as outlined in Rule 73 of the Rules of Civil Procedure for the United States District Court. Pursuant to those rules in these proceedings the Notice of Appeal (Tr: pages 142 and 143) specifies the orders from which the appeal is taken. As required by the rule the Clerk of the District Court sent copies of the Notice of Appeal to attorneys of record for all interested parties, including Charles D. McCarty as Trustee, the latter being designated as Appellee in the Appellant's Opening Brief filed herein. (See Clerk's Docket pages in B-5720 under entry of 2-23-67 and 2-27-67.) The Notice of Appeal (Tr: 142 and 143) does not designate an appellee. This is not required by Rule 73. The caption on the Notice of Appeal is "In the Matter of The Lusk Corporation, a Delaware corporation, et al, Debtors", the caption of the case in the District Court.

Subsequent to the filing and mailing of the notice of appeal the appellant herein filed a motion with the District Court seeking to limit the papers to be forwarded to the Circuit Court to those which appeared to be essential for the presentation of the questions on appeal. In this connection a designation

of the record sought was filed and a statement of points filed. The motion to limit the contents of the file to be forwarded to the Circuit Court was noticed for hearing and came on for hearing. In connection with the filing of the documents above named copies were served on all counsel of record, namely: the same persons to whom the Clerk of the District Court had mailed copies of the Notice of Appeal. At the hearing of the motion to limit the papers to be forwarded, the only party appearing and taking any part in the proceedings was Charles D. McCarty, the Trustee. (See Clerk's entry 3-2-67, Clerk's Documents No. 329 and 330, and Docket Entry 3-8-67.) Thereafter the Trustee, and no one else, filed a request for additional record on appeal (Tr: 147) and the District Court entered an order limiting the record (Tr: 148, Clerk's Docket 3-9-67 and 3-10-67). By reference the reporter's transcript of proceedings on December 6, 1965, at Pages 1 and 2, it is apparent that the Trustee theretofore appointed in B-5720 intervened in the proceedings in B-5696 (See Clerk's Docket B-5696, 12-6-65 and Document No. 18). From the beginning the record is replete with advocacy by the Trustee on behalf of the petitioning creditors as well as all other creditors except this appellant.

Thus, the only person who has shown any interest in this appeal other than the appellant is the Trustee. (See Motion for Leave to Intervene, Tr: 45; Motion to Approve Involuntary Petition, Tr: 46; Motion to Consolidate, Tr: 48 and 90; and the action of the Referee allowing the Trustee to intervene, Reporter's Transcript page 3, hearing on December 6, 1965.)

The record thus discloses that all attorneys of record were served with the notice of appeal, the designation of record, and the statement of points. As shown by the files in this appellate court, the appellant's opening brief was served on the attorneys; for the petitioning creditors, on the attorneys for the Trustee and on the Trustee.

Except for the Trustee and his attorneys of record, none of the persons upon whom notice of appeal was served nor any of those upon whom any of the other pleadings were served has deigned to come into the appeal proceedings at all. On page 10 of his brief the Trustee, appellee here, notes "The Trustee is not authorized by law to file an answer." It is submitted that probably the trustee is not authorized by law to take part in this appeal. Sections 47, 167 and 186 of the Bankruptcy Act set forth the powers and duties of the Trustee and taken in the

broadest of interpretations there is nothing there about defending or prosecuting a petition by creditors under Chapter X of the Bankruptcy Act, particularly, where if he is right, the Trustee may be defeating his very existence. But since the Trustee was allowed to intervene in the involuntary proceedings and no appeal from that order has been taken, the appellant probably cannot in good conscience state that there has been a complete default or failure to appear by any appellee, although there may be no authority for such action by the Trustee. It is submitted, however, that by reason of the state of the record as above pointed out, appellee's Proposition of Law No. I is untenable and should be rejected by the Court.

As to Proposition of Law No. II urged by appellee on Page 10 of his brief, he does not correctly state the appellant's position. While the appellant does contend that the involuntary petition must be dismissed, the appellant also contends that all of the issues raised by the involuntary petition and the answers thereto became moot upon the filing of the voluntary petition. There is no contention made that the proceedings in B-5720 concerning the voluntary



petition were improper. The contention is that by reason of the fact that before any order was made under Section 142 approving the involuntary petition as complying with Chapter X and as being filed in good faith in B-5696, a voluntary petition was filed in B-5720 by the debtor named in B-5696 and by several of the subsidiaries of the debtor praying for relief under Chapter X. This voluntary petition in B-5720 was filed November 4, 1965, at 4:30 p.m. (Tr: 81). On November 5, 1965, said petition was approved by the District Judge under Section 141 as complying with the provisions of Chapter X of the Bankruptcy Act and as having been filed in good faith (Tr: 86). The business and affairs of the debtor and its subsidiaries have been administered by the court through its trustee then appointed and succeeding trustees (Tr: 88 and 93). Those proceedings in B-5720 rendered the proceedings in B-5696 moot and became a final order subject only to modification should the petition be challenged by creditors before the time fixed for a 161 hearing and after a hearing held under Section 144 of the Bankruptcy Act (11 U.S.C. 544). Contemporaneously, the debtor named in B-5696, The Lusk Corporation, filed its answer admitting all

material allegations of the petition and required to be stated by a debtor seeking relief under Chapter X of the Bankruptcy Act pursuant to the provisions of Section 130 thereof (11 U.S.C. 530) (Tr: 19).

It is well established rule that where proceedings are or become moot the Court will not continue the litigation. This point is covered by appellant in its opening brief, but it seems not amiss to call to the attention of the Court that this is the practice generally in the Supreme Court of the United States. Montgomery Ward & Co., Inc., et al, v. U.S., 326 U.S. 690. From the time of the approval under Section 141 of the voluntary petition of the debtor in B-5720 on November 5, 1965, (Tr: 86) all proceedings in the involuntary proceeding on the petition filed in B-5696 became moot, for all relief that could have been obtained, had then been granted to all creditors in the proceedings in B-5720.

Nor can the "without prejudice" contentions of the Trustee have any bearing on the matter now before the Court. Here we are dealing with the continuation by the Court of a proceeding to determine issues none of which can have any meaning or bearing on the proceedings, and all of which have become moot as a

result of the operation of law upon the acts of the parties and the Court. When the issues became moot no one could be prejudiced; nor can any action by the parties by stipulation or agreement change the legal effect of what was in fact done.

The appellee was not prejudiced at the time the voluntary petition filed in B-5720 was approved by the District Judge under Section 141 of the Bankruptcy Act (11 U.S.C. 541) pursuant to which a Trustee was appointed. Without that approval he could not have been appointed a Trustee at all. (Sec. 112, 113, 114 and 115 of the Bankruptcy Act.) (11 U.S.C. 512, 513, 514 and 515.) In the case in which the voluntary petition was filed B-5720, the business and affairs of the debtor have been administered by the Court through its Trustee ever since. It is submitted at the time the District Judge made his election and approved the voluntary petition of the Lusk Corporation and several of its subsidiaries, the petitioning creditors in the involuntary proceedings, and at any time thereafter were free to go before the District Judge and seek approval under Section 142 of the Bankruptcy Act (11 U.S.C. 542), or if that was denied, to appeal the order of the District Judge



if they thought he was wrong in approving the voluntary petition. The way the pleadings were then framed that would have been an appropriate act; the answer filed by the debtor named in the involuntary petition admitted all material allegations required for such an approval. The Petitioner not only did nothing constructive along that line, but later they amended their petition to add new parties and new claims, which under Rule 15 of the Rules of Civil Procedure creates a new cause of action and does not relate back to the filing of the original petition but is considered as having been filed as of the date of the amendment. (Tr: 42, 57 and 66.)

The Report of the Referee - Special Master confirmed by the Court on January 23, 1967 (Tr: 149) establishes that the issues between the debtor and the petitioning creditors were made moot by the answer of the debtor. To quote from the Report of the Special Master in the transcript at Pages 122 and 123:

"14. The involuntary petition initiated by Morgan's Inc., Construction Materials Co., Inc., and Tucson Blueprint Co., Inc. against Lusk was filed in good faith.

"15. In its answer to the involuntary petition Lusk alleged that it could not continue in the operation of its business unless reorganized under Chapter X of the Bankruptcy Act and admitted its inability to pay its debts as they mature."

And Conclusions of Law appearing on Page 123 state as follows:

"IV As between Lusk and the petitioning creditors, the involuntary petition may be approved under Section 142 (11 U.S.C. 542) without proof of the alleged act of bankruptcy contained therein.

"V Lusk's admission of its inability to continue in the operation of its business unless reorganized under Chapter X of the Bankruptcy Act, coupled with the failure of Lusk to appear at the hearing on December 5, 1965, constitutes a consent on its part to the approval of the creditors' petition."

With respect to Propositions of Law Nos. III and IV of the appellee, it appears to the appellant that all that need to be said is that Section 24 of the Bankruptcy Act permits this appeal. The order under Section 142 in B-5696 from which this appeal is taken is certainly a controversy arising in proceedings in Bankruptcy. The order from which this appeal is taken has far reaching effects on the position of the



parties in B-5720 and calls for much useless procedure over an issue which is moot in B-5696 both by reason of the pleadings in that case and by reason of the proceedings in B-5720.

It is respectfully submitted that the Court should hold that the proceedings became moot with the filing and approval of the petition in B-5720 and if not, they certainly became moot with the filing of the answer of the debtor in B-5696, and there was no issue remaining in B-5696 to be heard. The order of the District Judge requiring the Referee in Bankruptcy sitting as a Special Master to conduct hearings to try some issue which can have no bearing in these proceedings should be reversed and set aside.

It now becomes important to consider the orders entered by the District Judge following a report of the Referee - Special Master, which came before the Court on the 23rd day of January, 1967. It is from this order from which this appeal is taken. The minutes of January 23, 1967 (Tr: 149-150 on Page 150) show that the Court directed that the Referee acting as Special Master ". . . shall with all feasible dispatch, set down for hearing and hear: The Motion of Hotpoint Division of General Electric Company for Dismissal of the Involuntary Petition in B-5696;

the issues raised by the answers of Hotpoint Division of General Electric Company to involuntary petition; the issues raised by the answers heretofore or hereafter properly filed by any person excepting the debtors to the involuntary petition in B-5696 and B-5720 respectively."

It must now be pointed out that long before that, the time for any creditor to file any answer or other pleading in B-5720 had been closed by the effect of the order entered by the Court in B-5720 on November 17, 1965, fixing the 161 hearing in that case as of January 4, 1966. (Tr: 92 and 98.) Pursuant to that order of November 17, 1965 one answer had been filed by First Federal Savings and Loan. (Document 28, Clerk's Docket B-5720, January 3, 1966.) No other person or corporation filed any answer or other pleading attacking the voluntary petition filed by the Lusk Corporation and its subsidiaries in B-5720. Had the petitioning creditors any complaint against this voluntary petition this is when and where they should have filed any attack upon those proceedings.

Now to go back to the order of January 23, 1967. Notwithstanding the record before him, the Judge found

that the involuntary petition filed against the Lusk Corporation only in B-5696 complied with the requirements of Chapter X of the Bankruptcy Act, and that said petition had been filed in good faith; and then directed that the involuntary petition be approved under Section 142 (11 U.S.C. 542); that the involuntary petition be consolidated with the pending proceedings in B-5720 and again fixed a 161 hearing to be held on the 23rd day of March, 1967, and directed that notice thereof be given and the form of such notice (Tr: 69 and 79). This order directed that the notice be given in both cases, B-5696 and B-5720. In this same order the Court approved and adopted the findings of fact and conclusions of law of the Special Master which are set forth in the transcript of record commencing on Page 115. The Court, by this approval, adopted the conclusions of law of the Special Master set forth on Page 123 of the transcript. Particular attention is directed to Conclusions of Law Nos. II, III, IV, XIV and XV. These conclusions of law were confirmed by the Judge so they may be said to be the Conclusions of Law from which the appellant appeals.

The Lusk Corporation and its subsidiaries having sought and obtained Chapter X relief in B-5720 and The Lusk Corporation having consented to the creditors petition in the involuntary proceedings, it is the position of this appellant that there are no further issues to be heard and that collateral issues between petitioning creditors and other creditors are moot and that it is improper and beyond the jurisdiction of the Court to insist that these issues be heard and tried in B-5696 since the time to raise any issues was already foreclosed in B-5720 by the order fixing the 161 hearing in that proceeding. It is therefore beyond the jurisdiction of that Court to insist that all creditors be given another chance to file answers in the involuntary proceedings and in the voluntary proceedings all over again and that any issues raised in either proceeding be heard by the Referee - Special Master in connection with the final approval under Section 144 of the Bankruptcy Act. Likewise, it is even more pointless to insist that the answers filed in B-5696 be now tried before the Referee-Special Master for that proceeding involves only one of the debtors named in B-5720 and can avail no one anything.

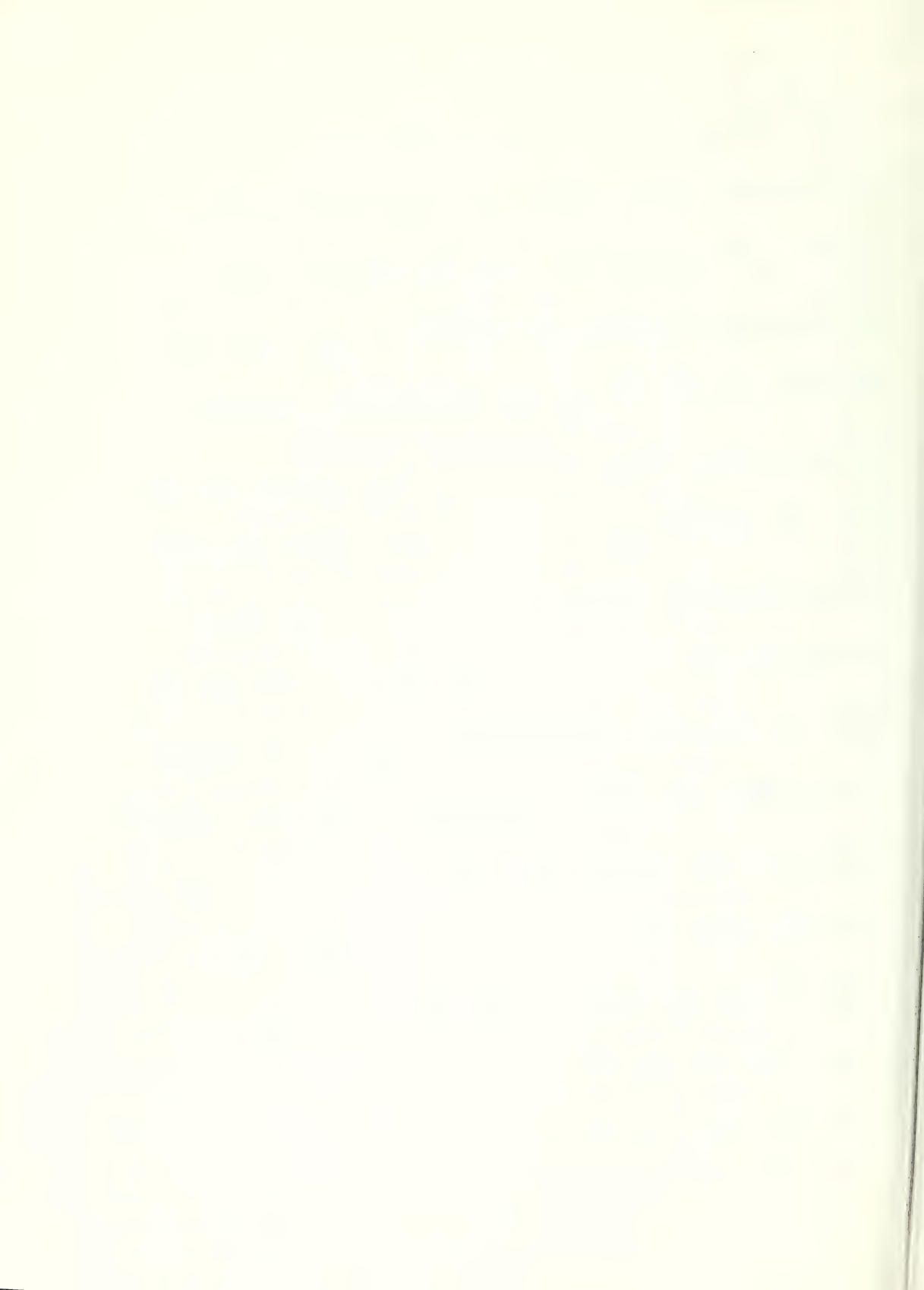


That the Judge considered the two proceedings to be separate must be apparent by reason of the difference in the way he handled them. In B-5696 he did no more than issue a restraining Order (Tr: 17). This is the limit of his power pursuant to Sections 112 and 113 of the Bankruptcy Act until the approval of the petition. In case B-5720 he appointed a Trustee and issued a restraining order pursuant to Sections 112, 113, 114, 115, 116 and 119 (11 U.S.C. 512, 513, 514, 515, 516, and 519) of the Bankruptcy Act, and fixed a time for hearing under Section 161 of the Act. (Tr: 88 and 93) He also recognized the difference when he entered his order of consolidation (Tr: 69). There he did not just approve the petition as properly filed in B-5696 and consolidate those proceedings with B-5720; on the contrary he related everything back to the filing of the petition in B-5696 (Tr: 70 and 71), an obvious attempt to cure any failure of jurisdiction should Section 126 of the Bankruptcy Act (11 U.S.C. 526) be held to be jurisdictional and not permissive only. The creditors petitioning in B-5696 also recognized the difference in the two proceedings. They asked for no more than a restraining order against suits, etc. in that proceeding. (Tr: 13) They did not ask for



a trustee nor any of the relief that was granted in B-5720. In fact when it came to the issue of certificates of indebtedness, they were issued under B-5720. (See Clerk's Docket B-5720, Documents 176, 177 and 204; Appendix E), the proceeding in which the Judge had approved the petition, by Lusk Corporation and its subsidiaries, (Tr: 86) pursuant to Section 141 (11 U.S.C. 541) as authorized by Section 119 (11 U.S.C. 519).

The contention in appellee's Proposition of Law No. V that the order from which this appeal is taken is the approval required by Section 141 of the Bankruptcy Act is in error. The order entered under Section 141 of the Act was entered in B-5720 and has not been attacked by any party. The order from which this appeal is taken is the order which was entered by the Court after the report of the Referee - Special Master on the involuntary petition. This order was entered under Section 142 (11 U.S.C. 542); it was not entered until a year after the proceedings in B-5720 and the entry of the order under Section 141. The only parties who had appeared in B-5696, the involuntary petition, up to the time of the entry of the order in said B-5720 under Section 141, approving



the petition as properly filed, were the debtor (that is the Lusk Corporation only) and the three petitioning creditors. In the involuntary petition these petitioners filed an answer on November 5, 1965, the day of the entry of the order in B-5720 approving the voluntary petition (Tr: 26).

As heretofore stated it is the contention of the appellant that the proceedings in B-5720 are a complete defeat of the proceedings in B-5696. Appellant will now advert to specification of Error No. 1 (d), (e) and (f), and Proposition of Law III. An attempt to further delineate its position is in order since from the appellee's brief it appears that he failed to comprehend fully the position of appellant. The attention of the Court is again directed to the record in B-5720 and to the order of the Court in these proceedings on November 17, 1965, fixing the time for a hearing under Section 161 of the Bankruptcy Act (Tr: 93-101). The date of this hearing was fixed for January 4, 1966. No answer contesting the allegations of the debtor's petition in B-5720 was filed by any creditor with the exception of a vague and indefinite answer filed on January 3, 1966, by First Federal Savings & Loan Association. In

connection with this answer, First Federal Savings & Loan Association succeeded in getting all of its interest and demands satisfied on a compromise agreement with the Trustee, which agreement is reflected in Documents 66 and 83, filed with the Clerk of the Court on February 18, 1966, and on March 10, 1966. Copies of these documents are attached to this brief as Appendixes A and B. They are in the record by reason of being in the files of the Clerk, but have not been included in the Abstract, and of course, are available to the Court pursuant to Rule 75(h) of the Rules of Civil Procedure if the Court cares to examine them. The answer of First Federal is included in the abstract and appears at Page 106 of the transcript of the record. Of course, after January 4, 1966, at the conclusion of the 161 hearing, it then became the duty of the Court to set for hearing any answer which had then been filed. Section 144 of the Bankruptcy Act.

Within a reasonable time after the 161 hearing, the disputes between the First Federal, Lusk and the Trustee apparently had become resolved so that there were no answers or proceedings of any kind to be taken under Section 144 (Appendixes A and B). The

Court had already entered an order under Section 141 and the condition precedent to an order under Section 144, to wit: An answer controverting material allegations of the petition and hearing thereon, had not occurred or been resolved, so no further order was necessary under the Bankruptcy Act. Hence, the talk by the appellee about Section 145 has no bearing on the question now before the Court. The conduct of the Court in B-5720 subsequent to the 161 hearing on January 4, 1966, and the record of the proceedings as reflected in the Docket pages of B-5720 will bear out this interpretation of the record as it exists.

From the foregoing, it thus appears that since the appointment of the Trustee in B-5720 and the approval of the petition under Section 141 in B-5720 there has been no purpose whatsoever of the proceedings in B-5696 because all of the proceedings in that case, which is the case where the petition was filed by the petitioning creditors against the Lusk Corporation only, are entirely useless and can afford no relief to anyone, least of all to the petitioning creditors who filed the proceedings.

Because the Court may consider the suggestion of the appellee that Section 126 (11 U.S.C. 526) is jurisdictional it is necessary to discuss that Section at this time. It is submitted that Section 126 (11 U.S.C. 526) must be read in connection with Sections 127 and 128. Sections 127 and 128 (11 U.S.C. 527-528) determine the venue for filing any petition under Chapter X. This meaning is fortified by Section 236 (11 U.S.C. 636) of the Bankruptcy Act. With this latter Section in mind, Section 126 (11 U.S.C. 526) can have but one meaning; that is 126 (11 U.S.C. 526) confers the right upon either a corporation or three creditors to file a petition for Chapter X relief. Here we have petitioning creditors on one hand and a debtor and its subsidiaries on the other hand having filed separate Chapter X petitions in the same Court; no question of the venue therefore between the two petitioners can exist. Had any action been taken by the petitioning creditors to challenge the voluntary petition by reason of the priority of the involuntary petition, the Judge would have found it necessary to decide the meaning of Section 126 (11 U.S.C. 526) and its effect. The Judge was advised and had knowledge of both petitions, as well as the answer filed in B-5696.



On Page 11 of his brief the appellee tells of the chaos which will follow should the Court sustain the position of the appellant. It is quite the other way. The dismissal of the involuntary petition is the only way in which these proceedings may be allowed to continue in an orderly manner. The position of the appellee to the effect that issues raised by any creditor or debtor by a pleading directed to the involuntary petition in B-5696 must be disposed of under Section 144 (11 U.S.C. 544) before the proceedings in B-5720 can be operative, and that upon such disposition under Section 144 the proceedings must be undertaken anew (although such disposition be of an immaterial issue as distinguished from a material issue) will create chaos indeed. His position that neither a creditor or a trustee could be a party to an appeal from an order under Section 144, could only be true were no creditor or trustee to file an answer or other appropriate pleading under Section 137 prior to a 161 hearing. The second approval under Section 144 is only required if an answer raising an issue under Section 137 is tried. For more than two years the affairs of the Lusk Corporation and several of its subsidiaries have been managed under the operation of a trustee in B-5720 appointed after the

approval of the voluntary petition pursuant to Section 141; its assets have been consumed by attrition of interest and taxes to a great extent. Some of its assets have been sold and some abandoned. The Trustee's bond certainly would be in jeopardy. Of course, this might be the best that could happen to the creditors! Actually, since the petitioning creditors in B-5696 have done nothing since the filing of this petition; have never filed or suggested a plan and by depositions taken long before the order from which this appeal is taken, excerpts of which are quoted and inserted in Appendixes C and D hereof, never had a plan. The petition should be dismissed under Section 236 (11 U.S.C. 636).

With the filing of the involuntary petition in B-5696 the Judge then had power over the assets of the corporation and as stated in the Act could exercise all powers of a bankruptcy court in a proceeding prior to an adjudication as well as issue restraining orders, injunctions, etc. Sections 112 and 113 of the Bankruptcy Act. No affirmative action was taken by the Court or the petitioning creditors, in the involuntary proceedings to grant or obtain any such relief. When the voluntary petition in

B-5720, filed by the debtor named in B-5696, and several of its subsidiaries, came before the Judge, he not only approved the petition under Section 141 but a few days later entered a supplemental order granting the relief authorized by Sections 114 and 115 of the Bankruptcy Act only upon or after the approval of a petition. (Tr: 86, 88, 89 and 93.) These were appealable orders. None of the parties to the involuntary proceedings sought to take any of the steps to effect an appeal from said orders and the time therefore now has long since lapsed.

c.f. In re Hudson and Manhattan Railroad Company, 138 F. Supp. 195 and In the Matter of Hudson & Manhattan Railroad Company, Debtor, in Proceedings for Reorganization pursuant to Chapter X of the Bankruptcy Act., Hudson & Manhattan Railroad Company, Debtor, Appellant, v. Herman T. Stichman, Trustee of the Debtor, et al., Appellee, and William J. Harding, Jr., et al., No. 173, Docket 23732, United States Court of Appeals, Second Circuit, 229 F.2d 616. At that time in the involuntary proceedings, the debtor had admitted all of the allegations required by Section 130 of the Bankruptcy Act and necessary to permit the Judge to approve the petition in B-5696 under Section 142 of the Bankruptcy Act, and



to then exercise the power conferred upon him by Sections 114 and 115 of the Bankruptcy Act. Instead he acted on the voluntary petition of the debtor and its subsidiaries. That act was an appealable order if he had improperly construed, read or interpreted Section 126 (11 U.S.C. 526), or through inadvertence had completely overlooked it.

As stated in Duggan v. Sansberry, 327 U.S. 499:

"This problem involves, of course, not the ordinary power of one court of general jurisdiction to question the jurisdiction of another court of general jurisdiction."

Here we have but one court and but one judge acting in both proceedings. Whether one petition or the other petition seeking relief under Chapter X was filed correctly or erroneously, all of the interested parties had an opportunity to come into the proceedings, and those who started the involuntary petition could have challenged the voluntary proceedings by a direct application to the Judge; instead, the voluntary proceedings were permitted to continue over a long course of time and many things were done therein, while the involuntary proceedings in B-5696 remained dormant. No one has ever taken any action to challenge the act of the District Judge in approving the voluntary petition filed in B-5720

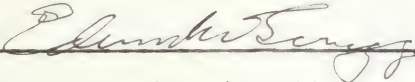


under Section 141 of the Bankruptcy Act (11 U.S.C. 541). The time for that to be done under Section 137 of the Bankruptcy Act (11 U.S.C. 537) was fixed as of January 4, 1966, the date set by the District Judge for the hearing required by Section 161 of the Bankruptcy Act (11 U.S.C. 561), or if any of the interested parties so desired, an appeal from the order under Section 141 could have been taken pursuant to Section 24 of the Bankruptcy Act within the statutory period after it was entered. The voluntary proceedings in B-5696 should have been considered as being abandoned. 1 Am Jur 2d Abatement Survival & Revival, Section 9, Page 47; 1 Am Jur Abatement, Section 14, Page 52. As pointed out in 1 C.J.S. 17, Abatement and Revival, page 52, a party may waive the abatement of the second suit if sufficient grounds are shown to base an estoppel. Here the petitioning creditors in B-5696 have taken no steps whatsoever to change the course of the Judge in B-5720. No appeal was taken and it is submitted this Court should reverse the order from which this appeal is taken and should hold that the involuntary proceedings were abandoned as well as moot and that no further action should be taken by the District

Court or the District Judge in B-5696-Tuc. except
to dismiss that proceeding.

Respectfully submitted this 29 day of
January, 1968.

LESHER, SCRUGGS, RUCKER, KIMBLE & LINDAMOOD

By 

Attorneys for Appellant
3773 East Broadway
Tucson, Arizona

APPENDIX A

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA

F I L E D
FEB 18 1966 3:30 p.m.
WM. B. LOVELESS, Clerk
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA
By Mae W. Turner
Deputy Clerk

In the Matter of)	In Proceedings for the Reorganization of Corpora- tions Pursuant to Chapter X
THE LUSK CORPORATION,		
et al.,		
Debtors.		

No. B-5720-Tuc.

PETITION FOR AUTHORITY TO SELL PROPERTY, TO
COMPROMISE CLAIMS, AND TO EMPLOY
ATTORNEYS FOR SPECIFIED PURPOSES

The petition of A. C. SIMON respectfully repre-
sents:

1. Petitioner is the duly appointed, qualified and acting Trustee of the above-named debtors.
2. At the time of the appointment of your petitioner, the Lusk Corporation was the owner of the following described real property consisting of building lots with improvements thereon in Maricopa County, Arizona:

Lots 2, 4, and 44 in Country Gables
according to Book 91 of Maps, Page 42,
records of Maricopa County, Arizona



Said corporation was also the owner of second mortgages on the following described improved lots in said Country Gables:

Lots 8, 41, 48, 96, 122, 146, 151, 156, 157, 159, 181, 182, 194, 224, 230, 248, 253, 292, 302, 324, and 320 in said subdivision.

3. Each of the second mortgages described in paragraph 2, was executed and delivered to the Lusk Corporation as security for purchase money notes executed and delivered to said Corporation by Donald G. Millett and wife.

4. Each of the lots described in paragraph 2 was, at the time of the appointment of your petitioner, and now is, subject to a first mortgage to First Federal Savings and Loan Association of Phoenix.

Each of the said first mortgages was and is delinquent; real property taxes upon all of the properties are delinquent, and many of the properties are deteriorating in value.

5. Prior to the appointment of your petitioner, because of delinquencies in the payments on the second mortgages above-described, suits were filed in Maricopa County, Arizona, to foreclose 19 of the said second mortgages. Said suits are now pending in Maricopa County, Arizona. In connection with



said foreclosure actions, and in connection with the settlement of claims arising pursuant to the second mortgages which were not the subject of foreclosure, the Lusk Corporation, prior to the appointment of your petitioner, had employed the Phoenix law firm of Kramer, Roche, Burch, Streik and Cracchiolo to file the said foreclosure actions and to represent the said corporation in connection with the second mortgages.

6. The actual value of the said second mortgages has decreased and will continue to decrease because of the following factors:

a. A general deterioration in the real estate market in the area.

b. A weathering and deterioration of the properties themselves.

c. Unpaid interest accruals.

d. Unpaid delinquent taxes which continue to accrue.

7. Petitioner has reviewed all of the properties in an attempt to determine the present cash value of petitioner's interest in the said properties. From the information available to your petitioner, petitioner alleges that with respect to some of the said properties, the value of your petitioner's

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interest has been destroyed by a combination of the circumstances above-enumerated, and that as to the remaining properties, the continued accrual of taxes and interest on the first mortgages are destroying the equity of petitioner. The cost of managing the properties is such that petitioner alleges that it is economically inadvisable for him to attempt to manage the said properties.

8. Petitioner has caused an investigation to be made of the financial position of the said Donald G. Millett and upon the base of said investigation, petitioner alleges that the financial position of the said Donald G. Millett is such that any substantial deficiency judgment against him would prove to be noncollectable.

9. A proposal has been made to your petitioner that he settle and compromise his position as to all of said properties upon the following basis:

a. First Federal Savings and Loan Association has offered to your petitioner the sum of \$3,000.00 in cash in payment for all of petitioner's interest in and to the said properties. Said offer is conditioned upon the employment by your petitioner of attorneys to procure the effective extinguishment



of any interest of the said Donald G. Millett and wife in any of said properties. Said First Federal Savings and Loan Association has further agreed to permit your petitioner to make any arrangement acceptable to petitioner with the said Donald G. Millett as to any deficiency, and to be bound by any such arrangement.

b. The said Donald G. Millett and wife have offered to your petitioner, in settlement of the claims of your petitioner, for deficiency judgments as to the second mortgages, the sum of \$1,300.00 cash, a promissory note payable on or before five years from date, executed by the said Donald G. Millett and wife, in the principal sum of \$6,700.00 bearing interest at the rate of 6% per annum, and the conveyance to petitioner of the following described property in Maricopa County, Arizona:

Lots 39, 68, 69, 72, and 73 in Poinsettia No. 2, Maricopa County, Arizona, according to the Document of record in the office of the County Recorder of Maricopa County in Docket 5091 at page 455.

which said property your petitioner is informed and believes it is worth approximately eight to ten thousand dollars at present market value.



c. The said firm of Kramer, Roche, Burch, Streik and Cracchiolo, by virtue of legal services performed in connection with said foreclosures, prior to the appointment of your petitioner, claims a lien upon any proceeds from said foreclosures, either by judgment or by compromise. Said firm has agreed to represent your petitioner in bringing about the effective extinguishment of the claim of the said Donald G. Millett and wife to the said properties, and to accept from petitioner in full settlement of any claim for services antedating the appointment of your petitioner and services performed by your petitioner, the sum of \$1,000.00.

d. First Federal Savings and Loan Association has agreed to pay to said law firm of Kramer, Roche, Burch, Streik and Cracchiolo, any amount in excess of \$1,000.00, claimed by said law firm on account of services performed in connection with the Millett mortgages, either before or after the date of the appointment of your petitioner.

10. Unnecessary expense would be entailed for this estate if other counsel is retained to represent petitioner in connection with the foreclosure of the Millett mortgages.



11. Your petitioner wishes to employ the said law firm of Kramer, Roche, Burch, Streik and Cracchiolo, for the specified purposes of representing him in connection with the Millett mortgages, and to bring about the extinguishment of the claims of the said Donald G. Millett and wife in and to any of said properties, by foreclosure judgment, or by compromise. Professional services to be rendered are the representation of your petitioner, the negotiation with the said Donald G. Millett and wife, the preparation of such documents as may be required in the event of a compromise, or the taking the foreclosure actions to final judgments in the event no compromise is possible.

12. The said law firm represents no interest adverse to the Trustee or this estate in the matters upon which it is to be engaged and the employment of said firm would be to the best interests of this estate.

WHEREFORE YOUR PETITIONER PRAYS:

1. That this Court approve and authorize the sale of the above-described properties for the above-enumerated considerations.



2. That this Court authorize the compromise of the above-enumerated claims upon the above-described basis.

3. That this Court approve the employment of the firm of Kramer, Roche, Burch, Streik and Cracchiolo for the specified purpose of representing your petitioner as Trustee in connection with the Millett mortgages as above-described for the flat fee of \$1,000.00, said fee to be in full payment of any claim of said firm as against your Trustee or as against the estate of the above-named debtor or in connection with all services rendered whether before or after the date of the appointment of your receiver and in full discharge of any claim of lien.

4. That your petitioner has such other and further relief as is just.

A. C. Simon
A. C. Simon, Trustee

Charles D. McCarty
Charles D. McCarty
304 So. Arizona Bank Bldg.
150 North Stone
Tucson, Arizona
Attorney for Trustee



STATE OF ARIZONA)
COUNTY OF PIMA) ss.:

I, A. C. SIMON, the petitioner named in the foregoing petition, do hereby make solemn oath that the statements contained therein are true according to the best of my knowledge, information and belief.

A. C. Simon
A. C. Simon

Subscribed and sworn to before me this 18th day of February, 1966.

Celia D. Garcia
Notary Public

My Commission expires:

7-4-68 (Seal)



APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA

F I L E D
MAR 10 1966 3:10 p.m.
WM. D. LOVELESS, Clerk
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA
By Mae W. Turner
Deputy Clerk

In the Matter of	}	In Proceedings for the Reorganization of Corpora- tions Pursuant to Chapter X
THE LUSK CORPORATION, et al.,		
Debtors.		
		No. B-5720-Tuc.

REPORT OF SPECIAL MASTER ON TRUSTEE'S PETITION TO
SELL PROPERTY, TO COMPROMISE CLAIMS AND TO EMPLOY
ATTORNEYS FOR SPECIFIED PURPOSES.

The above matter came on for hearing before the undersigned, sitting as Special Master on Thursday, March 3, 1966, at the hour of 10:00 a.m. Due notice of hearing was given in accordance with the order of the Court. The Trustee was in attendance in person and by his attorney. Evidence was adduced in support of the allegations of the petition, and now the undersigned having heard and considered all of the evidence and being fully advised in the premises, reports to the Court his finding that the allegations

contained in Trustee's petition are true and that the best interests of the estate of the above-named debtor require that Trustee be granted the relief prayed for in the form of order attached to this report.

DATED THIS 10 day of March, 1966.

Hugh M. Caldwell
Referee in Bankruptcy,
Sitting as Special Master

(Title of the foregoing Court and Cause No.
B-5720-Tuc.)

ORDER AUTHORIZING TRUSTEE TO SELL PROPERTY, TO
COMPROMISE CLAIMS AND TO EMPLOY ATTORNEYS FOR
SPECIFIED PURPOSES

The Honorable Hugh M. Caldwell, Referee in Bankruptcy, sitting as Special Master, having submitted to the Court his report on the petition of the Trustee for authority to sell property, to compromise claims and to employ attorneys for specified purposes, and the Court having considered said report and now finding that the best interests of the estate of the above-named debtor, require that the said petition be granted and that the Trustee be given the authority therein requested, it is therefore

ORDERED:

1. That Trustee be, and he is hereby, authorized to sell to First Federal Savings and Loan Association of Phoenix, Lots 2, 4 and 44 in Country Gables according to Book 91 of Maps, Page 42, records of Maricopa County, Arizona, together with second mortgages on the following described Lots in said Country Gables:

Lots 8, 41, 48, 96, 122, 146, 151, 156, 157, 159, 181, 182, 194, 224, 230, 248, 253, 292, 302, 324, and 320 in said subdivision,

for the sum of THREE THOUSAND AND NO/100 (\$3,000.00) DOLLARS cash.

2. That Trustee be, and he is hereby, authorized to compromise any and all claims which he as Trustee has against Donald G. Millet and Wife, because of alleged deficiencies on the second mortgages described in paragraph 1. above, for the sum of ONE THOUSAND THREE HUNDRED AND NO/100 (\$1,300.00) DOLLARS cash, a promissory note payable on or before five years from date, executed by the said Donald G. Millet and wife, in the principal sum of SIX THOUSAND SEVEN HUNDRED AND NO/100 (\$6,700.00) bearing interest at the rate of SIX (6%) per cent per annum, payable to Trustee, and the conveyance to Trustee by the said Donald G. Millet and wife of the following

described property in Maricopa County, Arizona:

Lots 39, 68, 69, 72, and 73 in Poinsettia No. 2, Maricopa County, Arizona, according to the Document of record in the office of the County Recorder of Maricopa County in Docket 5091 at page 455.

said property to be conveyed to Trustee free and clear of encumbrance.

3. The sale authorized in paragraph 1. above is not conditioned upon the consummation of the compromise set forth in paragraph 2. of this order, and in the event that the compromise described in paragraph 2. of this order is not consummated, said failure of consummation shall in no wise affect the authorization of sale envisioned in paragraph 1 hereof, it being understood that in the event of such failure of consummation, Trustee will proceed with his legal remedies against the said Donald G. Millet and wife.

4. That Trustee be, and he is hereby, authorized to employ the firm of Kramer, Roche, Burch, Streik and Cracchiolo for the purpose of representing Trustee in connection with the foreclosure suits now pending against Donald G. Millet and wife, the attempted consummation of the compromise above-described, and the extinguishment of any claim of

the said Donald G. Millet and wife to any of the above described property. For such services Trustee is authorized to pay to such firm the sum of ONE THOUSAND AND NO/100 (\$1,000.00) DOLLARS, said payment to be in full discharge of the liability of Trustee and of The Lusk Corporation for services performed by said firm, whether performed before or after the date of appointment of Trustee, in connection with the claims against Donald G. Millet and wife, said sum to be further in full discharge of any claim of lien which the said firm has because of any services antedating the appointment of Trustee. DATED THIS 10 day of March, 1966.

James A. Walsh

DISTRICT JUDGE



APPENDIX C

Excerpt from the deposition of Wilbert Anderson,
taken in Tucson, Arizona, November 30, 1965, In the
Matter of Lusk Corporation Debtor in B-5696-Tuc:

Page 11, Line 19

Q Now, in your petition under Chapter 10 of
the Bankruptcy Act, I believe you signed
as president of Tucson Blueprint Company,
Inc.

A That is true.

Q That petition was filed against the Lusk
Corporation, debtor, is that correct?

A Is that who it was filed for?

MR. HARRIS: Yes.

Page 16, Line 11

Q In the first sentence of that paragraph you
said petitioners desire that a plan for
the reorganization of the sake corporation
be effected.

What did you mean by that sentence?

MR. ROTHSCHILD: Same objection. My objec-
tion runs to this total line of questioning
as to what Mr. Anderson individually meant.

MR. SCRUGGS: As far as I am concerned you may --

MR. HARRIS: I would also join the objection.

THE WITNESS: Do I answer it?

MR. HARRIS: Yes, go ahead and answer. This is just a deposition.

THE WITNESS: I personally felt that the reorganization would give us a chance to recover.

Q (By Mr. Scruggs) What did you mean by a reorganization? Maybe I should put the question to you another way. What plan of reorganization did you have in mind?

A I truthfully didn't have any. It was in my mind this has happened in the past and these reorganizations have been possible.

Q Had you had any experience with reorganizations of businesses?

A Not directly, no, sir.



APPENDIX D

Excerpt from the deposition of A. Bates Butler,
taken in Tucson, Arizona, November 30, 1965, In the
Matter of Lusk Corporation, Debtor in B-5696-Tuc:

Page 5, Line 4

Q You did not? Now, you have filed a petition, or rather as a petitioning creditor in Case No. 5696 in the matter of the Lusk Corporation, is that correct?

A That is true.

Q You have a copy of your petition before you at this time?

A I have.

Q What is your relationship to Construction Materials Company, Inc.?

A Trustee in bankruptcy.

Q Is it actually in bankruptcy?

A It is in bankruptcy.

Q Now, in filing this petition you were acting as the trustee in bankruptcy, am I right?

A That is true.

Q And it's actually a petition by you as trustee in bankruptcy for Construction

Materials, Inc., am I correct?

A That is correct.

Page 22, Line 4

Q You made no inquiry?

A I did not. I understand Mr. Lusk has admitted that to be true.

Q Did he admit that to you?

A No, he admitted it in his answer.

Q And you have got the answer before you?

A Well, there is one right here. As a matter of fact, on his affidavit attached to the answer he says that the allegations contained in said petition which he denied in the foregoing answer are true.

MR. McCARTY: Typographical error.

MR. SCRUGGS: Say it again. What petition is he talking about?

THE WITNESS: In that answer which was filed with the petition in B-5696, Tucson, in the bankruptcy court under Chapter 10.

APPENDIX E

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ARIZONA

F I L E D

JUL 8 - 1966 8:43 a.m.

WM. H. LOVELESS, Clerk

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA

By Louise Clolland
Deputy Clerk

In the Matter of

THE LUSK CORPORATION;
et al.,

Debtors.

No. B-5720-Tucson

In Proceedings for the
Reorganization of a
Corporation, Chapter X.

ORDER AUTHORIZING TRUSTEE TO ISSUE CERTIFICATE OF
INDEBTEDNESS

The Special Master having submitted his report on the petition of Charles D. McCarty as trustee for authority to issue a certificate of indebtedness to Arizona Land Title & Trust Company evidencing the indebtedness of trustee to said company for moneys advanced by said company at the request of the trustee to pay administrative expenses; and

NOW, upon consideration of said petition and of said report, the Court finding that the best interests of the estates require that trustee be given the authority prayed for;



IT IS ORDERED, that Charles D. McCarty be, and he is hereby, authorized to issue a certificate of indebtedness in the sum of Eighteen Thousand Eight Hundred Twenty-three and 96/100 (\$18,823.96) Dollars, payable on or before one (1) year from the date of said certificate, the said sum and the said certificate to bear interest at the rate of six per cent (6%) per annum, the said interest to be payable on the several sums advanced from the date of the actual advance by the said Arizona Land Title & Trust Company.

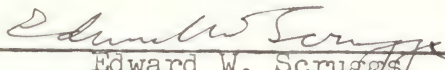
DATED this 8 day of July, 1966.

James A. Walsh

UNITED STATES DISTRICT JUDGE

CERTIFICATE

I certify that, in connection with the preparation of this Brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.



Edward W. Scruggs

No. 21813

In the
United States Court of Appeals
FOR THE NINTH CIRCUIT

SWITCHMEN'S UNION OF NORTH AMERICA, et al,
Appellants,
v.

SOUTHERN PACIFIC COMPANY,
Appellee.

*Appeal From the United States District Court
For the Northern District of California
Southern Division*

BRIEF OF APPELLANTS

LEO M. O'CONNOR,
O'CONNOR & LEWIS,
Bank of Sacramento Bldg.,
629 J Street,
Sacramento, California,
and

BAKER, JORDAN & FOREMAN,
1610 Tower Petroleum Bldg.,
1907 Elm Street,
Dallas, Texas,
Attorneys for Appellants.

FILED

MAR 19 1968

WM. B. LUCK, CLERK

MAR 21 1968

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No. 21813

In the
United States Court of Appeals
FOR THE NINTH CIRCUIT

SWITCHMEN'S UNION OF NORTH AMERICA, et al,
Appellants,
v.

SOUTHERN PACIFIC COMPANY,
Appellee.

*Appeal From the United States District Court
For the Northern District of California
Southern Division*

BRIEF OF APPELLANTS

To the Honorable Court of Appeals:

This appeal is taken from an Order of the United States District Court for the Northern District of California, Southern Division, entered on March 16, 1967, granting a preliminary injunction to the Appellee, Southern Pacific Company, enjoining Appellants from continuing a work stoppage instituted on or about March 12, 1967, and all acts in furtherance thereof, and from picketing or interfering with the

orderly and prompt continuation of work in Appellee's operations. The complaint filed by Appellee sought an injunction terminating such work stoppage and seeking damages in the amount of \$2,000,000.00 per day. Although the Appellee railroad unilaterally instituted a practice directly contrary to many years of practice in the industry, and contrary to an existing agreement between the Switchmen's Union and Appellee, without proper notice to Switchmen's Union under the Railway Labor Act, the District Court found that this was a minor dispute under the Railway Labor Act, concluding that the work stoppage was caused and conducted by Appellants in violation of the Railway Labor Act. Thereafter, Appellants gave Notice of Appeal, and have now duly perfected the present Appeal from the Judgment of the District Court entered against them.

PRELIMINARY STATEMENT

The underlying dispute of the strike and work stoppage called by Appellant, Switchmen's Union of North America, on March 12, 1967, arose out of these facts: Prior to Friday, February 20, 1967, four yardmasters, including one J. D. Shockley, were employed by Appellant on its property at Tucumcari, New Mexico; as of that date the last of the four Tucumcari yardmaster positions, including that held by Yardmaster Shockley, was abolished by Appellant. On March 11, 1967 Yardmaster Shockley was permitted by Appellee to displace Yardmaster James L. Hill, at Southern Pacific's Tucson Yard, who at that time held a yardmaster position at Appellee's property at Tucson, Arizona. Yard-

master Hill had been promoted to yardmaster in the Tucson Yard under Article 12 (a) of a yard agreement, dated September 1, 1956, then in existence between Appellant, Switchmen's Union of North America, and Appellee, Southern Pacific Company, which section read as follows:

"Section (a). Switchmen will be promoted in their respective yards, helper to foreman, foreman to yardmaster; seniority and ability to govern. As a prerequisite to promotion to yardmaster, it will be necessary for the applicant to have served at least one (1) year (306 days) as engine foreman in the yard where promoted * * *"

As of March 11, 1967, employees of the Southern Pacific Company of the craft of yardmen and switchmen were represented by Switchmen's Union of North America, and the yardmaster employees of Southern Pacific were represented by Railroad Yardmasters of North America, Inc. .

On March 29, 1965, the Railroad Yardmasters of North America, without the knowledge, consent, or participation of Appellant, entered into an agreement with the Southern Pacific and adopting the following rule as Article 8, Section (a) of such agreement:

"Yardmasters included within the scope of this agreement constitute one seniority class. A yardmaster's seniority will begin from the date that he is assigned to a position by assignment notice, except as otherwise provided in this article, and shall be confined to the yard where promoted as long as yardmaster's service is maintained in such yard. In the event all yardmasters' service is thereafter discontinued at such yard, any yardmaster who transfers therefrom to another yard where yardmaster's service is maintained, within six months of the date the last yardmaster's assign-

ment is discontinued, shall be accorded the same seniority date as yardmaster in the yard to which he transfers except that any yardmaster promoted in that yard prior to June 1, 1963 will have protected seniority in that yard * * *

Any yardmaster who transfers to another yard under this provision will qualify for yardmaster's service in that yard on his own time."

The affidavit of John Burge correctly describes the history and development of practices of Southern Pacific on this particular point (R. 26).

It is undisputed that Yardmaster Shockley had not completed 306 days of service as an engine foreman in the Tucson Yard as of March 11, 1967, as had Yardmaster Hill, whom he displaced. Appellants contended in the trial court that Article 8, Section (a) of the Railroad Yardmasters Agreement was in direct conflict not only with Section 12 (a) of the Agreement then in effect between Switchmen's Union of North America and Southern Pacific, but also with 47 years of established practices with Switchmen's Union and 27 years of established practices with Railroad Yardmasters of America, and therefore the action of Southern Pacific in unilaterally promulgating Article 8, Section (a) and displacing Yardmaster Hill with Yardmaster Shockley on March 11, 1967, was a direct and unequivocal unilateral abrogation of the rule then in effect with Switchmen's Union as well as a unilateral abrogation of the long established practices. Appellants further contended that a major dispute was created, and since no Section 6 Notice had been given to them Appellee violated the Railroad Labor Act, and that a labor dispute, within the meaning of the Norris LaGuardia Act,

29 U.S.C., Sections 101 through 115, was created. Appellants took the position in the trial court that this matter involved a major dispute within the meaning of Section 6 of 45 U.S.C. 156, relegating and freeing Appellants to use self-help, including a work stoppage, and that Appellee was not entitled to an injunction under the Railway Labor Act, 45 U.S.C. 151, et seq., and the Norris LaGuardia Act, 29 U.S.C. 101, et seq.

POINTS OF ERROR

FIRST POINT OF ERROR

The District Court erred in granting injunctive relief to Appellee because the work stoppage involved in this case was the result of a major dispute under the Railway Labor Act, 45 U.S.C. 151.

SECOND POINT OF ERROR

The District Court erred in granting injunctive relief in this case for the reason that such action violates the provisions of the Norris-LaGuardia Act, 29 U.S.C. 101.

THIRD POINT OF ERROR

The District Court erred in granting injunctive relief herein without making a specific finding that Appellee complied with all obligations imposed by law and made every reasonable effort to settle the dispute underlying this work stoppage either by negotiation or with the aid of any available governmental machinery or of mediation or voluntary arbitration, as required by Section 108 of the Norris-LaGuardia Act, 29 U.S.C.

POINTS OF ERROR — (Restated)**FIRST POINT OF ERROR — (Restated)**

The District Court erred in granting injunctive relief to Appellee because the work stoppage involved in this case was the result of a major dispute under the Railway Labor Act, 45 U.S.C. 151.

SECOND POINT OF ERROR — (Restated)

The District Court erred in granting injunctive relief in this case for the reason that such action violates the provisions of the Norris-LaGuardia Act, 29 U.S.C. 101.

THIRD POINT OF ERROR — (Restated)

The District Court erred in granting injunctive relief herein without making a specific finding that Appellee complied with all obligations imposed by law and made every reasonable effort to settle the dispute underlying this work stoppage either by negotiation or with the aid of any available governmental machinery or of mediation or voluntary arbitration, as required by Section 108 of the Norris-LaGuardia Act, 29 U.S.C.

STATEMENT, ARGUMENT AND AUTHORITIES

On the Southern Pacific Lines in question, since 1918, switchmen, irrespective of which union was certified, have had the exclusive right of promotion or appointment from switchmen to yardmaster, and yardmen promoted in respective yards only had yardmaster seniority in the yard where promoted. This practice was uniformly applied on the

Southern Pacific Lines even after passage of the amendment to the Railroad Yardmasters of America agreement on March 29, 1965. It is the position of Appellants that Southern Pacific, had no right unilaterally to change and abolish this established practice of promoting switchmen to yardmasters in such yards in this manner or to nullify and abrogate the rule in the bargaining agreement between Switchmen's Union and Southern Pacific in this respect without service of a Section 6 Notice and the utilization of the procedures set up under the Railway Labor Act, 45 U.S.C. 156, which provides as follows:

“Sec. 156 Procedure in changing rates of pay, rules and working conditions

Carriers and representatives of the employees shall give at least thirty days' written notice of an intended change in agreements affecting rates of pay, rules, or working conditions, and the time and place for the beginning of conference between the representatives of the parties interested in such intended changes shall be agreed upon within ten days after the receipt of said notice, and said time shall be within the thirty days provided in the notice. In every case where such notice of intended change has been given, or conferences are being held with reference thereto, or the services of the Mediation Board have been requested by either party, or said Board has proffered its services, rates of pay, rules, or working conditions shall not be altered by the carrier until the controversy has been finally acted upon, as required by section 155 of this title, by the Mediation Board, unless a period of ten days has elapsed after termination of conferences without request for or proffer of the services of the Mediation Board. May 20, 1926 c. 347 Sec. 6, 44 Stat. 582; June 21, 1934, c. 691, Sec. 6, 48 Stat. 1197.”

In *Rutland Ry. Corp. v. Brotherhood of Locomotive Engineers, et al*, 307 F. 2d 21, the Court, in determining whether a railroad was entitled to an injunction to halt a strike, the railroad had sought unilaterally to change train runs. The Court noted that the dispute between the carrier and employees was not whether or not the train runs in question should be rescheduled, but instead whether the railroad had the unilateral right to make them without negotiating about them with the unions, which is also a vital part of the disagreement in this case. The Court, in attempting to apply the test as to what is a "major" and "minor" dispute formulated in *Elgin, J&E Ry. v. Burley*, 325 U. S. 711, held:

"It is a major dispute if the present agreements between the railroad and the brotherhoods contain express provisions contrary to the position taken by the railroad or if the clear implication of these agreements is inconsistent with the railroads' proposals. It is a minor dispute if there is a clearly governing provision in the present agreements, although its precise requirements are ambiguous; and it is also minor if what the railroad seeks to do is supported by customary and ordinary interpretations of the language of the agreements." (Emphasis ours).

In this case Southern Pacific has taken a position in direct contradiction of the express provisions of the Switchmen's Union Agreement, and the clear implication of such agreement. Further, the action of the railroad is certainly not supported by customary and ordinary interpretations of the language of the agreements or by the established practices since 1918, but is clearly and specifically contrary to them. Hence this is a major dispute, and the railroad was not

entitled to the injunctive relief granted by the Court below; the *Rutland case*, supra, should control here. The Court, in *Rutland*, supra, determined that in the agreement there before the Court there were some provisions which by themselves did not bestow the right upon the railroad unilaterally to change train runs and home terminals, but did give some indication of an implicit recognition of such a right in the carrier and that therefore the ensuing dispute was a minor dispute. Here there is no such implicit recognition, either in the Switchmen's agreement or in the established practices and working conditions. However, the Court noted that the Supreme Court of the United States in *Brotherhood of R.R. Trainmen v. Toledo P&W R.R.*, 321 U. S. 50, has insisted upon compliance with Section 108 of the Norris-LaGuardia Act, which provides as follows:

“Sec. 108. Noncompliance with obligations involved in labor disputes or failure to settle by negotiation or arbitration as preventing injunctive relief.

No restraining order or injunctive relief shall be granted to any complainant who has failed to comply with any obligation imposed by law which is involved in the labor dispute in question, or who has failed to make every reasonable effort to settle such dispute either by negotiation or with the aid of any available governmental machinery of mediation or voluntary arbitration. Mar. 23, 1932, c. 90, Sec. 8, 47 Stat. 72.”

The Court then held:

“In the present case the District Court made no *finding* whether the management of the railroad made the good faith efforts which we have held to be a prerequisite to the obtaining by it of injunctive relief * * *

Therefore we must remand the case for the District Court to determine whether the railroad *made reasonable efforts* to settle this dispute in conference. See *Pa. R.R. v. Transport Workers Union*, 178 F. Sup. 30 (E.D. Pa. 1957) (Finding No. 15), Appeal dismissed, 3 Cir., 278 F. 2d 693 (1960). If the District Court finds that the railroad has not done so, it should not issue the injunction until the railroad has perfected its right to such relief by compliance with its statutory obligation."

In the instant case, the Complaint of Appellee seeking injunctive relief in this cause (R. 1), is totally devoid of any pleading that it brought itself within Section 108 of the Norris-LaGuardia Act, nor did the District Court below make any finding of fact regarding any such efforts made or any conclusion as to the reasonableness thereof, as required by 29 U.S.C. 108, in its Order granting the preliminary injunction on March 16, 1967.

The District Court erred in awarding injunctive relief to Appellee without making the required findings necessary under the Norris-LaGuardia Act, under the authority of *Brotherhood R.R. Trainmen of Toledo P&W R.R.*, *supra*, and *Rutland Ry. Corp. v. Brotherhood of Locomotive Engineers*, *supra*. The pertinent provisions of the Norris-LaGuardia Act, 29 U.S.C. 101, et seq., provides as follows:

"Sec. 101. Issuance of restraining orders and injunctions; limitation; public policy

No court of the United States, as defined in this chapter, shall have jurisdiction to issue any restraining order or temporary or permanent injunction in a case involving or growing out of a labor dispute, except in a strict conformity with the provisions of this chapter; nor shall any such restraining order or temporary or permanent

injunction be issued contrary to the public policy declared in this chapter. Mar. 23, 1932, c. 90 Sec. 1, 47 Stat. 70."

"Sec. 104. Enumeration of specific acts not subject to restraining orders or injunctions.

No court of the United States shall have jurisdiction to issue any restraining order or temporary or permanent injunction in any case involving or growing out of any labor dispute to prohibit any person or persons participating or interested in such dispute (as these terms are herein defined) from doing, whether singly or in concert, any of the following acts:

(a) Ceasing or refusing to perform any work or to remain in any relation of employment;

(b) Becoming or remaining a member of any labor organization or of any employer organization, regardless of any such undertaking or promise as is described in section 103 of this title;

(c) Paying or giving to, or withholding from any person participating or interested in such labor dispute, any strike or unemployment benefits or insurance, or other moneys or things of value;

(d) By all lawful means aiding any person participating or interested in any labor dispute who is being proceeded against in, or is prosecuting, any action or suit in any court of the United States or of any State;

(e) Giving publicity to the existence of, or the facts involved in, any labor dispute, whether by advertising, speaking, patrolling, or by any other method not involving fraud or violence;

(f) Assembling peaceably to act or to organize to act in promotion of their interests in a labor dispute;

(g) Advising or notifying any person of an intention to do any of the acts heretofore specified;

(h) Agreeing with other persons to do or not to do any of the acts heretofore specified; and

(i) Advising, urging, or otherwise causing or inducing without fraud or violence the acts heretofore specified, regardless of any such undertaking or promise as is described in section 103 of this title. Mar. 23, 1932, c. 90 Sec. 4, 47 Stat. 70."

"Sec. 113. Definitions of terms and words used in chapter.

When used in this chapter, and for the purposes of this chapter —

(a) A case shall be held to involve or to grow out of a labor dispute when the case involves persons who are engaged in the same industry, trade, craft, or occupation; or have direct or indirect interests therein; or who are employees of the same employer; or who are members of the same or an affiliated organization of employers or employees; whether such dispute is (1) between one or more employers or associations of employers and one or more employees or associations of employees; (2) between one or more employers or associations of employers and one or more employers or associations of employees; or (3) between one or more employees or associations of employees and one or more employees or associations of employees; or when the case involves any conflicting or competing interests in a "labor dispute" (as defined in this section) of "persons participating or interested" therein (as defined in this section).

(b) A person or association shall be held to be a person participating or interested in a labor dispute if relief is sought against him or it, and if he or it is engaged in the same industry, trade, craft, or occupation in which such dispute occurs,

or has a direct or indirect interest therein, or is a member, officer, or agent of any association composed in whole or in part of employers or employees engaged in such industry, trade, craft or occupation.

(c) The term "labor dispute" includes any controversy concerning terms or conditions of employment, or concerning the association or representation of persons in negotiating, fixing, maintaining, changing, or seeking to arrange terms or conditions of employment, regardless of whether or not the disputants stand in the proximate relation of employer and employee.

(d) The term "court of the United States" means any court of the United States whose jurisdiction has been or may be conferred or defined or limited by Act of Congress, including the courts of the District of Columbia, Mar. 23, 1932, c. 90, Sec. 13, 47 Stat. 73."

The question on this appeal revolves primarily around whether or not this labor dispute constituted a "major dispute", or a "minor dispute", and in either case, whether the provisions of the Norris-LaGuardia Act prohibit the issuance of an injunction under such circumstances. It is fairly well settled as a general proposition that under certain circumstances a minor dispute, involving the interpretation and application of an existing collective bargaining agreement, which has not been decided by the National Railroad Adjustment Board, is enjoinable. *Brotherhood of Railroad Trainmen v. Chicago River & I. R.R.*, 353 U. S. 30 (1957); *Louisville & Nashville R.R. v. Brown*, 252 F. 2d 149 (5th Cir. 1958). Such cases hold that where a minor dispute occurs, it is necessary to construe the general provisions of the Norris-LaGuardia Act in a fashion so as not to do vio-

lence to the specific provisions of the Railway Labor Act, thus protecting the jurisdiction of the Railway Adjustment Board. Here, no application or interpretation is necessary; under the *Rutland case*, supra, this case involves a unilateral change in an agreement and established working conditions. It is equally well settled that the Railway Labor Act limits the Railroad Adjustment Board's jurisdiction to disputes between an employee or group of employees and a carrier or carriers growing out of grievances or out of interpretations or applications of agreements concerning working conditions, and that no jurisdiction is conferred over disputes arising out of proposed or intended changes in the terms or application of the existing agreements, and that the Norris-LaGuardia Act does apply to labor disputes where its application is in conformity with the policy of the Railway Labor Act, thus prohibiting enjoying a work stoppage. *Brotherhood of R. Trainmen v. Toledo, P. & E. R. Co.*, 321 U. S. 50 (1944); *O.R. T. v. C&NW R. Co.*, 362 U. S. 330 (1960); *Butte, Anaconda, & P. Ry. Co. v. Brotherhood of L.F.&E.*, 269 F. 2d 54, cert. den., 361 U. S. 864; *MKT Ry. v. Randolph*, 164 F. 2d 4, cert. den., 334 U. S. 818.

The Supreme Court of the United States, in *Elgin, Joliet & Eastern R. Co. v. Burley*, 325 U. S. 711, 89 L. Ed. 1886, first formulated the often cited attempted definition of what constitutes a major and minor dispute:

"The first relates to disputes over the formation of collective agreements or efforts to secure them. They arise where there is no such agreement or where it is sought to change the terms of one, and therefore

the issue is not whether an existing agreement controls the controversy. They look to the acquisition of the rights for the future, not to assurance of rights claimed to have vested in the past.

The second class, however, contemplates the existence of a collective agreement already concluded or, at any rate, a situation in which no effort is made to bring about a formal change in terms or to create a new one. The dispute relates either to the meaning or proper application of a particular provision with reference to a specific situation or to an omitted case. In the latter event the claim is founded upon some incident of the employment relation, or asserted one, independent of those covered by the collective agreement, e.g., claims on account of personal injuries. In either case the claim is to rights accrued, not merely to have new ones created for the future.

In both types of disputes, major and minor, the Railway Labor Act requires that as a first step the parties make every reasonable effort to settle their differences in conference; in a major dispute, the subsequent procedure for the party intending to make a change in contract terms as written or established by practice and interpretation is a Section 6 Notice, followed by conference, referral to mediation, arbitration, and lastly, the creation of an Emergency Board by the President of the United States. The Railway Labor Act does not create any tribunal having final authority to decide a major dispute, and therefore there is no prohibition against a peaceful work stoppage when such procedures have been exhausted without settlement. *Brotherhood of R.R. Trainmen v. Chicago River & Ind. R.R.*, 353 U. S. 30; *Brotherhood of R.R. Trainmen v. Toledo, P&W R.R.*, 321

U. S. 50; *Order of R.R. Telegraphers v. Chicago & N.W. R.R.*, 362 U. S. 330. Here, Southern Pacific unilaterally changed the existing terms of the Switchmen's Union agreement and established practices without complying with any of such procedures set out above as contemplated and provided for by the Railway Labor Act.

This case does not present facts illustrating a jurisdictional dispute between two unions as to which craft or class of employees is entitled to do any specific work, as in *Order of Railway Conductors v. Pitney*, 326 U. S. 561 (1946) and *Transportation Communication Employees Union v. Union Pacific R.R.*, 385 U. S. 157, which disputes were held, to be minor disputes, primarily on the basis that the question of what should properly constitute a class or craft of employees is historically a question fraught with technicalities and requiring special expertise and knowledge of the railroad industry, which is what gave rise to Congress granting jurisdiction to the Railway Adjustment Board in the first instance. Here, the work being done by Yardmaster Shockley on March 11, 1967 was admittedly to be performed by the craft of yardmasters, and Switchmen's Union of North America raises no question here but that such position was properly filled by a person belonging to the class of employees known as yardmasters. The specific position would have been filled in any event by a yardmaster; the simple fact remains that in this instance a yardmaster was promoted

to such position in the Tucson Yard in specific violation of the agreement of the Switchmen's Union governing the promotion of yardmasters from switchmen in that particular yard, and we do not believe the record is contradicted that the rules regarding promotion of yardmasters from switchmen was quite properly a function of the Switchmen's Union of North America under long and well established practices concerning these working conditions and the express terms of the bargaining agreements. It should be made clear to this court that Appellant, Switchmen's Union of North America, is not attempting to bargain or represent in any fashion members of the craft of yardmaster; however, it is entitled to bargain and represent yardmen/switchmen and the requisites and requirements of promotion to yardmaster, which is within its jurisdiction, and is entitled to insist that the railroad not make a unilateral change in the terms of their working agreement and the established practice and application of such agreement without complying with the Railway Labor Act.

Unlike the *Pitney case*, *supra*, which involved a dispute as to which craft of employees, conductors or trainmen, would operate certain trains, and where all parties sought to support their particular interpretation of their agreements by evidence as to practices, customs and where the factual question was intricate and technical, compelling the court to defer such questions to the Railroad Adjustment

Board, even a cursory examination of the instant case reveals that the railroad here has by its actions simply abrogated a long standing practice concerning working conditions and the clear provisions in the Switchmen's Union Agreement, not as to what class of employees or craft would perform the work in question, but as to which men would be promoted from the ranks of the switchmen. The same is true with reference to the *Transportation—Communication Employees Union case*, supra, where there was a factually complicated question as to whether the clerks or telegraphers as a craft should perform jobs remaining after automation. The case of *Southern Pacific Company v. Switchmen's Union of North America*, 356 F. 2d 332, cited by Appellee to the Court below, is also not in point for the same reasons.

It is the position of Appellant that the proposed change in working conditions by Southern Pacific will result in a change in such bargaining agreement, that is, if Southern Pacific is able to assign yardmasters in yards where they have not served 306 days as an engine foreman in direct contradiction of Section 12 (a) of the Switchmen's Agreement. Whether or not a proposed change is actually to be reflected or will effect a change in an existing agreement is to be tested as a matter of substance, inasmuch as a carrier in imposing changes in no wise contemplated or arguably covered by an agreement is not to escape the impact of the act merely through its unilateral action which it pur-

posely intends not to become a part of a written agreement. *United Industrial Workers of Seafarers International Union of North America, et al v. Board of Trustees of the Galveston Wharves, et al*, 351 F. 2d 183; *Florida East Coast Railway v. Board of Railroad Trainmen*, 336 F. 2d 172; *Florida East Coast Ry. Co. v. United States*, 348 F. 2d 682. These cases illustrate a carrier is not entitled to take unilateral action in clear and specific contradiction to existing terms of a collective bargaining agreement without creating a major dispute which leaves the union the lawful right to use self-help.

CONCLUSION

The judgment against Appellants cannot be sustained because the underlying dispute herein is a major dispute under the Railway Labor Act because the carrier has sought to unilaterally change existing terms of a collective bargaining agreement and forty-seven years of established practices without proper notice to Appellants, and the granting of an injunction in such a labor dispute is prohibited by the Norris-LaGuardia Act, and because the District Court failed to make a finding that Appellee complied with all obligations imposed by law and made every reasonable effort to settle the dispute underlying this work stoppage as specifically required by Section 108 of the Norris-LaGuardia Act.

WHEREFORE, Appellants respectfully pray that the judgment of the Trial Court be in all things reversed and for

such other and further relief, in law or in equity, which the Court deems proper.

Respectfully submitted,

LEO M. O'CONNOR,
O'CONNOR & LEWIS,
Bank of Sacramento Bldg.,
629 J Street,
Sacramento, California,

and

BAKER, JORDAN & FOREMAN,
1610 Tower Petroleum Bldg.,
1907 Elm Street,
Dallas, Texas,

By:

Russell M. Baker
Attorneys for Appellants.

CERTIFICATE OF SERVICE

I, RUSSELL M. BAKER, Attorney of Record for the Appellants do hereby certify that I served the above and foregoing Brief of Appellants upon Honorable WILLIAM R. DENTON, Attorney for Appellee herein, on the 13th day of March, 1968, by mailing a copy to him at 65 Market Street, San Francisco, California 94015, by certified mail, last known address of Attorney for Appellee.

Russell M. Baker
Russell M. Baker



STATEMENT OF JURISDICTION

The
for the Ninth Circuit has jurisdiction
by virtue of Section 1292 (a)

FOLD OUT

OUT



No. 21813

In the
United States Court of Appeals
For the Ninth Circuit

SWITCHMEN'S UNION OF NORTH AMERICA,
et al.,

Appellants,

vs.

SOUTHERN PACIFIC COMPANY,

Appellee.

Appeal from the United States District Court
for the Northern District of California

Brief of Appellee

FILED

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WM. B. LUCK, CLERK

WILLIAM R. DENTON

W. A. GREGORY

65 Market Street

San Francisco, Calif. 94105

Attorneys for Appellee.



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Brief of Appellee

STATEMENT OF THE CASE

Appellants called a strike of all switchmen on Appellee's Pacific Lines (seven western states) on March 12, 1967, in order to force the Appellee to nullify the displacement of one yardmaster by another at Tucson, Arizona, on the 11:00 p.m. shift March 11, 1967. It was stipulated that the strike caused substantial damage to Appellee (TR 71). The strike was enjoined by the District Court on the grounds that it violated the Railway Labor Act in that the underlying issue presented a minor dispute. Appellants appeal from the injunction. The nature of the case becomes apparent upon analysis of the undisputed facts.

Appellee's switchmen are represented by Switchmen's Union of North America. Appellee's yardmasters are represented by the Railroad Yardmasters of North America, Inc. Appellee has separate collective bargaining agreements with each union for each respective craft of employees.

In evidence are the following agreements:

Exhibit 1—between Appellee and Appellants covering most of Appellee's switchmen, including those at Tucson (TR 16).

Exhibit 2—between Appellee and its yardmasters (TR 17).

Exhibit 3—between Appellee, Appellants, and the yardmasters, a tripartite agreement (TR 27).

Exhibit A—between Appellee and Appellants covering switchmen not under Exhibit 1 (TR 33). This agreement covers switchmen in yards at Tucumcari, New Mexico, El Paso, Texas, and Douglas and Bisbee, Arizona.

Under the switchmen's agreements (Exhibits 1 and A), every switchman has seniority as a switchman at every yard within a seniority district on Appellee's Pacific Lines. All points referred to in this action are in a single seniority district for switchmen. Yardmasters normally are promoted from the ranks of switchmen and also retain switchmen's seniority. Under the yardmasters' agreement (Exhibit 2), a yardmaster has seniority as a yardmaster at every yard at which he has seniority as a switchman.

The underlying dispute arises out of events and actions concerning one yardmaster employee of Appellee. Early in 1967, Appellee closed its yard at Tucumcari and discontinued all yardmaster service there. A number of switchmen then exercised their seniority to work at other yards. Two of the yardmasters at Tucumcari dropped back to the

ranks of switchmen and exercised their seniority as such in another yard. Another yardmaster named Shockley also could have exercised his switchman's seniority at Tucson, El Paso, or other yards. This is undisputed. It is also undisputed that he could have exercised his yardmaster's seniority at El Paso. This action never would have arisen had Yardmaster Shockley thus utilized his seniority in either craft. But he did not.

Instead, Yardmaster Shockley exercised his seniority to displace Yardmaster Hill at Tucson. Appellants called the strike in protest of Shockley's displacement of Hill. Both men were employed at the time in the craft of yardmasters and not in the craft of switchmen, and Shockley was senior to Hill as a yardmaster. But Appellants' protest was based on the fact that Shockley was not a Tucson man. He was properly promoted to yardmaster from the ranks of switchmen in a yard other than Tucson. His promotion was under the switchmen's agreement which is Exhibit A.

Appellants contend that under the terms of Article 12a of Exhibit 1, to work as a yardmaster at Tucson, an employee must have been promoted from the ranks of Tucson switchmen. Appellee agrees that Article 12a prescribes the manner and qualifications for *promotion* of switchmen at Tucson, but contends that the issue here is one of *assignment* of yardmasters. Once a switchman has been promoted, he is a yardmaster for all purposes, and he need not be promoted elsewhere or at successive yards. And once promoted to the craft of yardmasters, the exercise of a yardmaster's seniority to hold a yardmaster's assignment or to displace another yardmaster is governed by agreement with the craft of yardmasters (Exhibit 2), and not by an agreement with the craft of switchmen. Thus, under the yardmasters' agreement, Shockley had more seniority in the craft of yardmasters at Tucson than did Hill and his displacement was

proper, regardless of the fact that he was promoted to yardmaster at a different yard. Shockley's assignment was in accordance with Article 8a of the yardmasters' agreement (Exhibit 2), and was not in violation of any promotion rule of the switchmen's agreement.

Under the yardmasters' agreement, Shockley had to exercise his seniority if he could or else give it up (TR 46). He chose to exercise it. Had the Appellee acquiesced in Appellants' view and told Shockley that he could not displace Hill as a yardmaster, Shockley would have been able to challenge the Appellee's interpretation of his seniority rights by filing a grievance, and the dispute could have ultimately gone through the National Railroad Adjustment Board's Fourth Division for final adjudication. Clearly, the issue if raised by Shockley would have been a minor dispute under the Railway Labor Act (45 U.S.C. 153).

Thus, the issue on the merits is whether Shockley's displacement of Hill was a matter of assignment and displacement under the yardmasters' agreement or one of promotion under the switchmen's agreement. The propriety of the interpretation and application of the agreements is in issue. The proper resolution of the question depends upon the interpretation of both agreements, and of the other agreements also (Exhibits 3 and A), insofar as any party considers them relevant.

The District Court, after hearing testimony and receiving evidence, concluded that the issue between the parties was a minor dispute and that the strike could be properly enjoined.

“. . . it does appear to me that what we get to is a showing that there are contracts, there are agreements, there are sections in these agreements which apply whether you are going to apply them as purely promotional agreements, that is, methods of promotion, or whether you are going to consider them as conferring

rights or restraining rights to bump, or to take a job by a yardman, or by a yardmaster in other yards than that in which he received his original promotion, these rules are there, are attempting to delineate these very problems.

Now, how they apply and where they apply must be determined, I think, by a Board, by some adjustment board.

This is the problem before us. It's not this Court's duty or province in this proceeding to go into the merits of these claims. We have the contracts. We have the provisions of the contracts. We have the machinery set up in these various contracts to cover apparently these very situations which give rise to this dispute.

So far as the evidence goes, I can see only one thing before me, and that is Mr. Shockley's right to go down from Tucumcari to Tucson. I see no more involved than one man's right to one job, if he has such a right." (TR 136-137)

Since the issuance of the preliminary injunction, the merits of the dispute were submitted to the National Railroad Adjustment Board. Notice was given to Appellants in accordance with the Board's procedures. The Board took jurisdiction and the Fourth Division rendered its Award No. 2262 and Order in Docket 2306 on February 7, 1968, holding that Appellee properly interpreted and applied the controlling agreement when it permitted Yardmaster Shockley to displace Yardmaster Hill. A copy of the Award and Order are attached hereto as Appendix A.

STATEMENT OF THE ISSUE

This appeal raises only one issue—namely, is the dispute over which Appellants called the strike a minor dispute under the Railway Labor Act, 45 U.S.C. 153?¹ If it is minor,

1. Portions of the Railway Labor Act, 45 U.S.C. 152-153, are set forth in Appendix B.

as the District Court concluded, the issuance of the preliminary injunction was proper.

Although the complaint seeks damages, other issues relating thereto have not been tried and are not part of this appeal. The Court is merely asked to determine the magnitude of the underlying dispute under the Railway Labor Act, i.e., whether it is major or minor. It is not asked to, and indeed it may not, analyze the various collective bargaining agreements to determine the merits of the underlying dispute. As noted above, the National Railroad Adjustment Board already has taken jurisdiction of the dispute and rendered its decision on the merits (Appendix A).

SUMMARY OF THE ARGUMENT

Appellee's position is that the District Court correctly construed the dispute over which Appellants called the strike to be a minor dispute under the Railway Labor Act. A strike over a minor dispute may properly be enjoined without regard to the Norris-LaGuardia Act. *Brotherhood of Railroad Trainmen v. Chicago River & Indiana R.R.*, 353 U.S. 30 (1957).

The appeal involves a classic type of minor dispute. It is a case of one employee asserting his apparent seniority rights pursuant to an existing agreement. The question is whether or not he had a right to the assignment he sought. The contentions of the parties bring into issue several existing collective bargaining agreements and, according to Appellants, over 30 years of practice under them. The solution to the dispute involves interpreting the applicable agreement or agreements and accommodating them if necessary. It is the basic function of the National Railroad Adjustment Board to resolve the dispute, and since the commencement of the action it has done so (Appendix A).

Its authority and obligation to do this is plain. *Order of Railway Conductors v. Pitney*, 326 U.S. 561 (1946); *Transportation-Communication Employees Union v. Union Pacific R.R.*, 385 U.S. 157 (1966), *rehearing denied*, 385 U.S. 1032. Appellee denies any intention or attempt to modify the terms of any agreement with Appellants (TR 57).

ARGUMENT

I. The Dispute Which Motivated Defendants to Strike Is a Minor Dispute Over the Assignment or Promotional Rights of an Employee of Plaintiff Pursuant to Existing Collective Bargaining Agreements.

The Court does not have the burden of resolving the merits of the dispute between plaintiff and defendants in the Shockley matter. The Court must decide only the magnitude of the dispute, i.e., whether it is major or minor under the Railway Labor Act, 45 U.S.C. 151, et seq.

While it is semantically easy for defendants to argue that any breach of an agreement is a repudiation of the agreement, it is substantively not possible in the field of railroad labor relations to label an alleged breach of an agreement a major dispute. The basic authority on the distinction between major and minor disputes is *Elgin, J. & E. R.R. v. Burley*, 325 U.S. 711 (1945). Defining first major and then minor disputes, the Court said:

“The first relates to disputes over the formation of collective agreements or efforts to secure them. They arise where there is no such agreement or where it is sought to change the terms of one, and therefore *the issue is not whether an existing agreement controls the controversy. They look to the acquisition of rights for the future, not to assertion of rights claimed to have vested in the past.*

“*The second class, however, contemplates the existence of a collective agreement already concluded, or,*

at any rate, a situation in which no effort is made to bring about a formal change in terms or to create a new one. The dispute relates either to the meaning or proper application of a particular provision with reference to a specific situation or to an omitted case." (p. 723) (Emphasis added.)

The instant case is not the first time a union which has disagreed with the railroad's application of its agreement has argued that the railroad changed the contract without complying with Section 6, 45 U.S.C. 156. *Hudie v. Aliquippa & Southern R.R.*, 249 F.Supp. 210 (W.D. Pa. 1966), *affirmed*, 360 F.2d 213 (3rd Cir. 1966), and *St. Louis, S.F. & T. Ry. v. Railroad Yardmasters of America*, 328 F.2d 749 (5th Cir. 1964), *cert. denied*, 84 S.Ct. 1886. The latter case involved the abolishment of several yardmaster positions at one time (as at Tucumcari). The question was whether the agreement provided for the multiple abolishments. The Court held that the question presented a minor dispute.

"The carrier was doing, so it said, what the contract authorized it to do and it was not doing what the Union said it was, to-wit: Seeking or proposing 'an intended change in *agreements* affecting rates of pay, rules, or working conditions.' So it is, that the carriers take the position that rather than being off base by not proceeding under Section 6 seeking to bargain for a change in existing agreements, it was strictly in line by acting under the existing contract and that it was in fact the Union that was off base in going to court to litigate the issue rather than pursuing grievance procedures by challenging the right of the carrier to abolish the positions under the terms of the existing contract and referring the issue to the Railroad Adjustment Board which the carrier contends has exclusive jurisdiction where a contract interpretation is involved." (p. 751)

Closely in point is *Order of Railway Conductors v. Pitney*, 326 U.S. 561 (1946). The dispute was over what employees were to fill certain assignments. (The same basic issue as in the instant case.) Two unions each insisted that its agreement and the practice thereunder applied and men from its craft were entitled to the assignments.

“... It alleged that its members had for the past 35 years operated the trains in issue as a result of negotiations as to rules, rates of pay and working conditions between it and the railroad and that the 1940 contract specifically provided that this situation would not be changed without further agreement. Thus, the proposed displacement of O.R.C. conductors would violate § 6 of the Railway Labor Act which makes it unlawful for a carrier or employee representatives to change ‘pay, rules, or working conditions,’ unless 30 days written notice of the intended change shall have been given and the controversy has been finally acted upon by the Mediation Board. The O.R.C. asked the court to instruct its trustees not to displace road conductors and to enjoin them permanently from taking such action so long as O. R. C.’s contracts with the road were not altered in accordance with the provisions of the Railway Labor Act.” (p. 563)

While the claim of the Conductors in the *Pitney* case was based on their agreement and 35 years of practice (the very claim the Appellants make in this case), the railroad denied the applicability of the conductors’ contract and asserted that the trainmen’s contract applied (the claim of Appellee in this case). Thus the Court said that the railroad’s denial put the interpretation of all contracts in issue and that it was a minor dispute for the Adjustment Board.

“These sections make it clear that the only conduct which would violate § 6 is a change of those working conditions which are ‘embodied’ in agreements. But the

answers here specifically denied that the O. R. C. agreements provided that road conductors operate the five trains in question. This put in issue the meaning of the contracts that allegedly embodied the working conditions which the trustees were about to change. The court, therefore, had to interpret these contracts before it could find that § 6 had been violated." (p. 565)

"... The record shows, however, that interpretation of these contracts involves more than the mere construction of a 'document' in terms of the ordinary meaning of words and their position. [Citations omitted.] For O. R. C.'s agreements with the railroad must be read in the light of others between the railroad and B. R. T. And since all parties seek to support their particular interpretation of these agreements by evidence as to usage, practice and custom, that too must be taken into account and properly understood. The factual question is intricate and technical. An agency especially competent and specifically designated to deal with it has been created by Congress. Under these circumstances the court should exercise equitable discretion to give that agency the first opportunity to pass on the issue. Certainly the extraordinary relief of an injunction should be withheld, at least, until then. [Citations omitted.] Only after the Adjustment Board acts, but not until then, can it plainly appear that such relief is necessary to insure compliance with the statute. Until such time, O. R. C. can not show irreparable loss and inadequacy of the legal remedy. The court of equity should, therefore, in the exercise of its discretion stay its hand." (pp. 566-67)

There is no question or conflict in the judicial decisions on this point. A dispute over the right of an employee to displace on or hold a given assignment and the corresponding obligation of the railroad to give a certain employee the assignment is a minor dispute. The underlying dispute in *Pitney*, as in this case, is which employee is entitled to the

assignment. The principle of the *Pitney* case was reasserted in *Transportation-Communication Employees Union v. Union Pacific R.R.*, 385 U.S. 157 (1966), *rehearing denied*, 385 U.S. 1032:

“The railroad, the employees, and the public, for all of whose benefits the Railway Labor Act was written, are entitled to have a fair, expeditious hearing to settle disputes of this nature. And we have said in no uncertain language that the Adjustment Board has jurisdiction to do so. *Order of Railway Conductors v. Pitney*, 326 US 561, 90 L ed 318, 66 S Ct 322, was decided 20 years ago. That case concerned a dispute over which employees should be assigned to do certain railroad jobs, members of the conductors’ union under their contract or members of the trainmen’s union under their contract. In that case a district court, in charge of a railroad bankruptcy, had entered a judgment in favor of the conductors. We reversed, holding that the Railway Labor Act vested exclusive power in the Adjustment Board to decide that controversy over job assignments.” (p. 269)

To the same effect is *Slocum v. Delaware, L. & W. R.R.*, 339 U.S. 239 (1950).

Appellants assert that Appellee’s acquiescence in Shockley’s displacement at Tucson constituted “unilateral change” in Appellants’ agreement. The National Mediation Board, which administers much of the Railway Labor Act, in its annual report for 1967 commented upon the misunderstanding that underlies this assertion.

“Applications for the mediation services of the Board frequently indicate a misunderstanding as to the jurisdiction of the National Mediation Board and that of the National Railroad Adjustment Board. Such applications are received with the advice that a change made or proposed to be made by the carrier ‘constitutes a unilateral change by the carrier in the working

conditions of the employees without serving notice or conducting negotiations under section 6 of the act.' The Board is requested to take immediate jurisdiction of the dispute and call the carriers' attention to the 'status quo' provisions of section 6 of the act, i.e., have the carrier withhold making the change in working conditions, or restore the preexisting conditions if the change has already been made, until the dispute has been processed by the National Mediation Board.

Section 6 of the Railway Labor Act reads as follows:

Carriers and representatives of the employees shall give at least thirty days' written notice of an intended change in agreements affecting rates of pay, rules, or working conditions, and the time and place for the beginning of conference between the representatives of the parties interested in such intended changes shall be agreed upon within ten days after the receipt of said notice, and said time shall be within the thirty days provided in the notice. In every case where such notice of intended change has been given, or conferences are being held with reference thereto, or the services of the Mediation Board have been requested by either party, or said Board has proffered its services, rates of pay, rules, or working conditions shall not be altered by the carrier until the controversy has been finally acted upon as required by section 5 of this Act, by the Mediation Board, unless a period of ten days has elapsed after termination of conferences without request for or proffer of the services of the Mediation Board.

The organization in these instances will contend that proposed changes by the carrier should not be made without following the procedures cited in section 6 above. *These changes may involve assignment of individual employees or crews in road passenger or freight service, relocation of the point for going on and off duty in yard service, reduction of the number of employees through consolidations of facilities and changes which arise from development of new and improved method of work performance.*

The carrier, on the other hand, will maintain that the procedure of notice and conference outlined in section 6 does not apply as the section has application only to those working conditions incorporated in written rules which have been made a part of the collective bargaining agreement with the representative of the employees and by which the carrier has expressly restricted or limited its authority to direct the manner in which certain services shall be rendered by its employees.

It is clear then that disputes of this nature involve a problem as to whether the proposed change can be instituted without serving a notice of intended change in the agreement on the other party. This raises a question of application of the existing agreement to the pending proposal. Such a dispute is referable to the National Railroad Adjustment Board. On the other hand, if it is contended by the organization that the carrier has no right to make the proposed changes, and the carrier maintains that it is not restricted by the terms of the agreement from making the change, then the dispute pertains to the question of what the agreement requires and the dispute should be referred to the National Railroad Adjustment Board in accordance with section 3 of the Railway Labor Act for decision." (pp. 35-36) (Emphasis added.)²

Appellants cannot change the nature of the dispute by giving it their own label. The agreements cover problems of promotion and assignment. The parties disagree on their interpretation and application as to Shockley. This is the type of dispute the Adjustment Board was created to adjudicate. *Seaboard Air Line R.R. v. Castle*, 170 F.Supp. 327 (N.D. Ill. 1958); *Order of Railway Conductors v. Swan*, 329 U.S. 520 (1946).

2. Thirty-Third Annual Report of The National Mediation Board for the Fiscal Year ended June 30, 1967.

II. Appellants' Cases Are Not in Point Because They Assume the Wrong Conclusion.

Appellee has dwelt at some length on the facts of this case, although they are not in issue, because it is essential to understand the facts in order to determine the nature of the dispute between the parties. The cases are helpful in that they define the criteria and standards for making the determination. The *Burley* case, *supra*, is relied upon by both parties to state the general rule. The *Pitney* case, *supra*, and the *Yardmasters* case, *supra*, are closely analogous in their facts and contentions and compel the conclusion that the Shockley matter is a minor dispute.

Appellants assume that the case presents a major dispute under section 6 (45 U.S.C. 156) and cite authorities under section 6 to show that the federal courts may not enjoin strikes arising out of such disputes. Their cases involve major disputes, but the facts in those cases are not analogous to those of Yardmaster Shockley. Appellants' citations on page 14 of their brief, i.e., *Brotherhood of R.R. Trainmen v. Toledo P.&W. R.R.*, 321 U.S. 50 (1944); *Order of R.R. Telegraphers v. Chicago & N.W. Ry.*, 362 U.S. 330 (1960); and *Butte, Anaconda & P. Ry. v. Brotherhood of Locomotive Firemen & Enginemen*, 268 F.2d 54 (9th Cir. 1959), *cert. denied*, 361 U.S. 864, each involved formal demands by the carrier or union for a change in agreements. No such demand exists in the Shockley dispute. The disputes in Appellants' cases were major and Appellee does not question the holdings therein. The cases simply are not in point when considered in the light of Yardmaster Shockley's displacement of Yardmaster Hill. The other case on page 14, *Missouri-Kansas-Texas R.R. v. Randolph*, 164 F.2d 4 (8th Cir. 1947), *cert. denied*, 334 U.S. 818, is similar to the *Pitney* case and involved a jurisdictional dispute between unions. It did not involve a strike.

Appellants charge that, in standing by while Shockley took the Tucson assignment, Appellee "unilaterally" changed the switchmen's agreement. As explained in the National Mediation Board's Annual Report, *supra*, this is but a harsh sounding way to charge a breach of the switchmen's agreement. Particularly when only one assignment of one individual at one location is involved, it can be nothing more than the ordinary grievance or minor dispute. Appellants state in their brief at page 16:

"Here, the work being done by Yardmaster Shockley on March 11, 1967 was admittedly to be performed by the craft of yardmasters, and Switchmen's Union of North America raises no question here but that such position was properly filled by a person belonging to the class of employees known as yardmasters. The specific position would have been filled in any event by a yardmaster; the simple fact remains that in this instance a yardmaster was promoted to such position in the Tucson Yard in specific violation of the agreement of the Switchmen's Union governing the promotion of yardmasters from switchmen in that particular yard."

By their own analysis, the issue is which employee was entitled to hold the yardmaster assignment in Tucson. Or, stated another way, was Shockley entitled to fill the position? The answer requires an interpretation of the agreement rules. It is simply a grievance and minor dispute.

III. The Norris-LaGuardia Act Does Not Prevent Relief Against a Strike Over a Minor Dispute.

The Court may protect the jurisdiction of the Adjustment Board and the procedures of the Railway Labor Act, 45 U.S.C. 153, by enjoining a strike which would frustrate the peaceful procedures for settling disputes arising out

of the interpretation and application of collective bargaining agreements. *Brotherhood of Railroad Trainmen v. Chicago R. & I. R.R.*, 353 U.S. 30 (1957). The ultimate issue of the *Chicago River* case was whether, in the light of the Norris-LaGuardia Act, the Court could enjoin a strike over a minor dispute. The Court concluded that the procedures of the Railway Labor Act (45 U.S.C. 153) for settling minor disputes were "compulsory arbitration" (353 U.S. 39), and that the mandates of the Railway Labor Act must take precedence over the Norris-LaGuardia Act.

"The only question which remains is whether the federal courts can compel compliance with the provisions of the Act to the extent of enjoining a union from striking to defeat the jurisdiction of the Adjustment Board. The Brotherhood contends that the Norris-LaGuardia Act has withdrawn the power of federal courts to issue injunctions in labor disputes. That limitation, it is urged, applies with full force to all railway labor disputes as well as labor controversies in other industries.

"We hold that the Norris-LaGuardia Act cannot be read alone in matters dealing with railway labor disputes. There must be an accommodation of that statute and the Railway Labor Act so that the obvious purpose in the enactment of each is preserved. We think that the purposes of these Acts are reconcilable." (pp. 39-40)

"In prior cases involving railway labor disputes, this Court has authorized the use of injunctive relief to vindicate the processes of the Railway Labor Act. *Virginian R. Co. v. System Federation No. 40*, 300 U.S. 515, was an action by the union to enjoin compliance with the Act's provisions for certification of a bargaining representative. The question raised was whether a federal court could issue an injunction in a labor dispute. The Court held:

‘It suffices to say that the Norris-LaGuardia Act can affect the present decree only so far as its provisions are found not to conflict with those of § 2, Ninth, of the Railway Labor Act, authorizing the relief which has been granted. Such provisions cannot be rendered nugatory by the earlier and more general provisions of the Norris-LaGuardia Act.’ *Id.*, at 563.

In *Brotherhood of Railroad Trainmen v. Howard*, 343 U.S. 768, and other similar cases, the Court held that the specific provisions of the Railway Labor Act take precedence over the more general provisions of the Norris-LaGuardia Act.

‘Our conclusion is that the District Court has jurisdiction and power to issue necessary injunctive orders [to enforce compliance with the requirements of the Railway Labor Act] notwithstanding the provisions of the Norris-LaGuardia Act.’ *Id.*, at 774.

This is a clear situation for the application of that principle.” (pp. 41-42)

Appellants quote at length from the Norris-LaGuardia Act, 29 U.S.C. 101, et seq. Their points may have some relevancy to a major dispute after all procedures of the Railway Labor Act have been exhausted. Such procedures (particularly mediation) were not invoked or exhausted in the Shockley matter because it is not a major dispute. The Norris-LaGuardia Act is no obstacle to enjoining a strike over a minor dispute. Appellants and Appellee agree on the rule of law for minor disputes.

“It is fairly well settled as a general proposition that under certain circumstances a minor dispute, involving the interpretation and application of an existing collective bargaining agreement, which has not been decided by the National Railroad Adjustment Board, is enjoinable. *Brotherhood of Railroad Train-*

men v. Chicago River & I. R.R., 353 U.S. 30 (1957); *Louisville & Nashville R.R. v. Brown*, 252 F.2d 149 (5th Cir. 1958). Such cases hold that where a minor dispute occurs, it is necessary to construe the general provisions of the Norris-LaGuardia Act in a fashion so as not to do violence to the specific provisions of the Railway Labor Act, thus protecting the jurisdiction of the Railway Adjustment Board." (Appellants' Brief, pp. 13-14)

Since the *Chicago River* case, the federal law of labor relations has progressed even further in its policy of favoring and encouraging arbitration as the means of settling minor disputes. Even doubtful cases are to be arbitrated. Doubt about the arbitrability of a dispute is to be resolved in favor of arbitration. *Steelworkers v. American Mfg. Co.*, 363 U.S. 564 (1960); *Steelworkers v. Warrior & Gulf Co.*, 363 U.S. 574 (1960); and *Steelworkers v. Enterprise Corp.*, 363 U.S. 593 (1960).

The Courts have consistently and uniformly upheld the issuance of an injunction to protect and preserve the jurisdiction of the administrative agency, i.e., the Adjustment Board. It is the compulsory and exclusive forum for the settlement of grievances and other minor disputes. The Shockley incident presents a classic case for the injunction. *Brotherhood of Locomotive Engineers v. Louisville & N. R.R.*, 373 U.S. 33 (1963); *Louisville & N. R.R. v. Brown*, 252 F.2d 149 (5th Cir. 1958), *cert. denied*, 356 U.S. 949; *Texas Pacific-Missouri Pac. Term. R.R. v. Brotherhood of Ry. Clerks*, 232 F.Supp. 33 (La. 1964); *Norfolk & Portsmouth Belt Line R.R. v. Brotherhood of R.R. Trainmen*, 248 F.2d 34 (4th Cir. 1957), *cert. denied*, 355 U.S. 914.

CONCLUSION

The procedures of section 3 of the Railway Labor Act (45 U.S.C. 153) provide the adequate and proper means for the adjustment of the Shockley grievance. Appellants' position constitutes nothing more than a charge that Appellee misapplied the promotion rule of Exhibit 1 when Shockley was permitted to displace Yardmaster Hill. This charge raises a minor dispute. It has been submitted by Appellee and the Yardmasters Union to the National Railroad Adjustment Board. The Board took jurisdiction, and a referee already has decided the dispute. There the matter should end.

It is respectfully submitted that the decision of the District Court issuing the preliminary injunction should be affirmed.

Respectfully submitted,

WILLIAM R. DENTON

W. A. GREGORY

65 Market Street

San Francisco, Calif. 94105

Attorneys for Appellee.

CERTIFICATE OF SERVICE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

WILLIAM R. DENTON

Attorney for Appellee

(Appendices Follow)



Appendix A

Award No. 2262

Docket No. 2306

Form 1

NATIONAL RAILROAD ADJUSTMENT BOARD FOURTH DIVISION

Referee John Day Larkin

Parties to Dispute:

Southern Pacific Company (Pacific Lines)
and

Railroad Yardmasters of North America, Inc.
vs.

Switchmen's Union of North America

Statement of Claim:

Petitioners' claim that Yardmaster J. D. Shockley, who was not promoted to yardmaster under Article 12(a) of the September 1, 1956, Switchmen's Agreement, had the right under Article 8(a) of the current agreement covering yardmasters to displace a junior yardmaster at Tucson following the discontinuance of the last yardmaster assignment at Tucumcari.

Findings:

The Fourth Division of the Adjustment Board upon the whole record and all the evidence, finds that:

The carrier and the employes involved in this dispute are respectively carrier and employes within the meaning of the Railway Labor Act, as approved June 21, 1934.

This Division of the Adjustment Board has jurisdiction over the dispute involved herein.

The Petitioners, Railroad Yardmasters of North America, Inc., and Southern Pacific Company, and the Respondent,

Switchmen's Union of North America, were given due notice of the hearing; the Petitioners appeared at said hearing; and the Respondent waived right of appearance at said hearing.

The right to negotiate with the carrier rules governing the performance of the work of the yardmaster craft, including the exercise of seniority to obtain positions covered by the yardmasters' agreement, is vested solely in the organization legally authorized to represent the yardmaster craft. See Awards 430, BRT v. IHB; 495, NPTC v. BRT; 1360, SUNA v. WP; and 1531, SUNA v. SP, by this Division. See also Switchmen's Union of North America v. Southern Pac. Co., C. A. Cal. 1958, 253 F. 2d 81, certiorari denied 79 S. Ct. 29, 358 U. S. 818, 3 L. ed. 2d 60, rehearing denied 79 S. Ct. 152, 358 U. S. 896, 3 L. ed. 2d 123, and Order of Railway Conductors and Brakemen v. Switchmen's Union of North America, C. A. Ga. 1959, 269 F. 2d 726, certiorari denied 80 S. Ct. 206, 361 U. S. 899, 4 L. ed. 2d 155. The controlling Agreement involved in this dispute is between the Railroad Yardmasters of North America, Inc., and the Southern Pacific Company and contentions to the contrary are invalid.

This Board, therefore, finds that the contentions of the petitioners must be sustained.

AWARD

Claim sustained.

NATIONAL RAILROAD ADJUSTMENT BOARD
By Order of Fourth Division

ATTEST: /s/ MURIEL L. HUMFREVILLE
Muriel L. Humfreville
Secretary

Dated at Chicago, Illinois, this 7th day of February, 1968.

Form 2(a)

NATIONAL RAILROAD ADJUSTMENT BOARD
FOURTH DIVISION

ORDER

To accompany (Award Number 2262
(Docket Number 2306

To Southern Pacific Company (Pacific Lines)
Mr. C. A. Ball, Manager of Personnel
65 Market Street
San Francisco, California 94115

Railroad Yardmasters of North America, Inc.
Mr. Robert C. Inman, General Chairman
153 Yosemite Avenue
Fresno, California 93701

The Division, after consideration of the Docket identified above, hereby orders that an award favorable to the petitioners should be made. The claim is sustained as set forth in the Award, a copy of which is attached and made a part of this Order.

NATIONAL RAILROAD ADJUSTMENT BOARD
By Order of Fourth Division

ATTEST: /s/ MURIEL L. HUMFREVILLE
Muriel L. Humfreville
Secretary

Dated at Chicago, Illinois, this 7th day of February, 1968.

Copy to Switchmen's Union of North America
Mr. John R. Burge, General Chairman
268 Market Street
San Francisco, California 94111

Appendix
Appendix B

Railway Labor Act, 45 U.S.C.

§ 152. General duties—Duty of carriers and employees to settle disputes

First. It shall be the duty of all carriers, their officers, agents, and employees to exert every reasonable effort to make and maintain agreements concerning rates of pay, rules, and working conditions, and to settle all disputes, whether arising out of the application of such agreements or otherwise, in order to avoid any interruption to commerce or to the operation of any carrier growing out of any dispute between the carrier and the employees thereof.

§ 153. National Railroad Adjustment Board—Establishment; composition; powers and duties; divisions; hearings and awards

First. There is established a Board, to be known as the “National Railroad Adjustment Board”, the members of which shall be selected within thirty days after June 21, 1934, and it is provided—

* * *

(h) The said Adjustment Board shall be composed of four divisions, whose proceedings shall be independent of one another, and the said divisions as well as the number of their members shall be as follows:

First division: To have jurisdiction over disputes involving train- and yard-service employees of carriers; that is, engineers, firemen, hostlers, and outside hostler helpers, conductors, trainmen, and yard-service employees. This division shall consist of ten members, five of whom shall be selected and designated by the carriers and five of whom

shall be selected and designated by the national labor organizations of the employees.

Second division: To have jurisdiction over disputes involving machinists, boilermakers, blacksmiths, sheet-metal workers, electrical workers, carmen, the helpers and apprentices of all the foregoing, coach cleaners, power-house employees, and railroad-shop laborers. This division shall consist of ten members, five of whom shall be selected by the carriers and five by the national labor organizations of the employees.

Third division: To have jurisdiction over disputes involving station, tower, and telegraph employees, train dispatchers, maintenance-of-way men, clerical employees, freight handlers, express, station, and store employees, signal men, sleeping-car conductors, sleeping-car porters, and maids and dining-car employees. This division shall consist of ten members, five of whom shall be selected by the carriers and five by the national labor organizations of employees.

Fourth division: To have jurisdiction over disputes involving employees of carriers directly or indirectly engaged in transportation of passengers or property by water, and all other employees of carriers over which jurisdiction is not given to the first, second, and third divisions. This division shall consist of six members, three of whom shall be selected by the carriers and three by the national labor organizations of the employees.

(i) The disputes between an employee or group of employees and a carrier or carriers growing out of grievances or out of the interpretation or application of agreements concerning rates of pay, rules, or working conditions, including cases pending and unadjusted on June 21, 1934,

shall be handled in the usual manner up to and including the chief operating officer of the carrier designated to handle such disputes; but, failing to reach an adjustment in this manner, the disputes may be referred by petition of the parties or by either party to the appropriate division of the Adjustment Board with a full statement of the facts and all supporting data bearing upon the disputes.

(j) Parties may be heard either in person, by counsel, or by other representatives, as they may respectively elect, and the several divisions of the Adjustment Board shall give due notice of all hearings to the employee or employees and the carrier or carriers involved in any disputes submitted to them.

* * *

(l) Upon failure of any division to agree upon an award because of a deadlock or inability to secure a majority vote of the division members, as provided in paragraph (n) of this section, then such division shall forthwith agree upon and select a neutral person, to be known as "referee", to sit with the division as a member thereof, and make an award. Should the division fail to agree upon and select a referee within ten days of the the date of the deadlock or inability to secure a majority vote, then the division, or any member thereof, or the parties or either party to the dispute may certify that fact to the Mediation Board, which Board shall, within ten days from the date of receiving such certificate, select and name the referee to sit with the division as a member thereof and make an award. The Mediation Board shall be bound by the same provisions in the appointment of these neutral referees as are provided elsewhere in this chapter for the appointment of arbitrators and shall fix and pay the compensation of such referees.

(m) The awards of the several divisions of the Adjustment Board shall be stated in writing. A copy of the award shall be furnished to the respective parties to the controversy, and the awards shall be final and binding upon both parties to the dispute. In case a dispute arises involving an interpretation of the award, the division of the Board upon request of either party shall interpret the award in the light of the dispute.

* * *



No. 21814 ✓

SEP 16 1968

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

J. HOWARD ARNOLD

APPELLANT

vs.

WILLIAM J. MCGUINNESS

APPELLEE

PETITION FOR REHEARING

Appeal from the
UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

FILED

SEP 13 1968

WM. B. LUCK, CLERK

J. HOWARD ARNOLD
Postoffice Box 919
Berkeley 1, California
Telephone LA 4-8473

Appellant, pro se

No. 21814

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

J. HOWARD ARNOLD

APPELLANT

VS.

WILLIAM J. McGUINNESS

APPELLEE

PETITION FOR REHEARING

Appeal from the
UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

J. HOWARD ARNOLD
Postoffice Box 919
Berkeley 1, California
Telephone LA 4-8473

Appellant, pro se

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the Honorable GILBERT R. JERTBERG, Circuit Judge,
BEN CUSHING DUNIWAY, Circuit Judge,
ROGER D. FOLEY, District Judge,
Judges of the United States Court of Appeals for the Ninth Circuit.

This Petition for Rehearing is respectfully presented to direct the Court's attention to certain controlling matters of fact and law which appear to have been overlooked in the course of rendering the decision of August 5, 1968, in this case.

I

THE OPINION FAILS TO JUSTIFY THE DECISION. Like the opinion in Case No. 853, also decided August 5, the 5-line Per Curiam opinion in this case completely fails to justify explicitly the anomalous and erroneous decision rendered:

"We have carefully considered appellant's assignments of error and they have no merit. We agree with and adopt the decision of the district court. We also reaffirm this Court's prior decisions, wherein J. Howard Arnold was twice before this Court as the appellant."

The decision of the District Court, accompanying its denial of a hearing on Appellant's motion to amend, failed completely to come grips with the basic issue, disqualification for interest, but sought, by misrepresenting the wording of the statute, to substitute waivable disqualification for bias and prejudice. Neither the District Court nor this Court, in the first McGuinness case, has ever made and stated a determination of the issues of the lack of subject-matter jurisdiction resulting from (1) the defective complaint or (2) the petition to quash. In the absence of such explicit determination of one issue among several, vagueness forbids application of res judicata doctrine to eliminate these issues, as Judge Carter has done. If there

was any reason to nullify the ancient principle of invoking subject-matter jurisdiction by filing a valid complaint, or any basis for ignoring the effect of a quashing statute that no State Supreme Court decision has yet declared void, that reason should have been stated. In the absence of such explicit statement, it must be presumed that the courts never reached the merits of the cases, but made arbitrary decisions based on extraneous circumstances peculiar to the given case, and with neither intention nor capability of establishing a precedent for res judicata. In the absence of answers to these three questions -- answers readily provided by jurisdictional law -- it is tragically obvious that justice according to law has not been rendered.

II

THE DISTRICT COURT DECISION ADOPTED IS ABSURD AND UNTENABLE. Judge Carter, in arriving at a decision adverse to Appellant, committed three errors: (1) He failed to consider disqualification for interest ignoring Appellant's principal contention; (2) He misquoted Section 170(5), which he sought to force upon Appellant in lieu of Section 170(1), replacing an unwaivable disqualification by a waivable one which Appellant was neither in position nor under obligation to use; (3) He erroneously charges Appellant with contending that Appellee lost jurisdiction because he "could have been disqualified", when the actual contention was that disqualification for interest and loss of jurisdiction were automatic. These errors are original with Judge Carter's opinion, and do not appear in Appellee's brief (which at least met Appellant's arguments, though ineffectively). Like Appellee Judge Carter ignores the priority taken by stare decisis over the res judicata doctrine which he is too eager to apply to decisions

which possess only the necessary priority in time but lack the more necessary validity of a truly final adjudication.

III

FEDERAL COURTS SHOULD ACCEPT STATE COURT INTERPRETATION OF STATE LAW. It is incumbent upon Federal courts, trial and appellate, to honor the interpretation of State laws made by the courts of the State, or in the absence of such interpretation to make their own, de novo. In the case at bar, the courts have done neither, but simply ignore the well established applicability of the disqualification-for-interest and the quashing statutes embodied in California law. Appellant has shown (Closing Brief, pp. 2-6) that the State courts have indeed interpreted the disqualification-for-interest statute favorably to his case. The quashing statute is likewise firmly upheld by prior State decisions (Clerk's Tr., pp.22-23) and should not be summarily disregarded by the Federal courts. To dismiss a prior case without express justification, ignoring State court decisions and stare decisis doctrine, then to point to that prior decision as res judicata, merely compounds the preposterousness of this Court's procedure without justifying it. The Court overlooks the principle that a void judgment is not validated by subsequent affirmation.

IV

THE BOSTICK DECISION IS IRRELEVANT AS WELL AS ERRONEOUS. Appellee's counsel persist in using the word "jurisdiction" without qualification, in order to draw unfounded analogies between cases. In Arnold v Bostick, quasi in rem jurisdiction was involved, and the case is not in point here. This Court adopted the opinion of the State Court of

appeal, which was based on two cases not in point and ignored many federal court decisions of opposite effect, for the evident purpose of upholding arbitrarily a wholly unjustifiable divorce-court order. The opinion in Arnold v. Bostick was written by Judge Hamlin, who had previously refused to disqualify himself even after Appellant's urging although he had long been a Superior Court judge in Alameda County. This Court's reaffirmation of the Arnold v. Bostick decision is not pertinent to the instant case, except perhaps to underline the application, in both cases, of the extra-legal doctrine that no judge is ever liable for damages in a civil suit for false imprisonment and a citizen of the United States cannot recover damages under the Civil Rights act when the defendant is a judge (Opening Brief, pp. 12-14).

V

THE DECISION REFLECTS UNFAVORABLY UPON THE COURT. It is significant that Appellant is (1) A disfavored litigant, unable to provide hired professional counsel, (2) A critic and antagonist of the injustice in California divorce courts, (3) An Alameda County resident involved in local politics in that highly corrupt county. Under these circumstances a decision adverse to him should bear close scrutiny and be clearly above the suspicion of being motivated by considerations other than justice according to law. This decision, Appellant's sixth in this court, follows a now established pattern of brevity of opinion, lack of conformity to established State and Federal law, and twisted logic in attempted justification of an obviously wrong decision. In the circumstances, it does not appear unreasonable for the public to expect of this Court a detailed opinion, squarely meeting the issues and explaining legal basis for the decision, together with a decision that is

emonstrably in full accord with State and Federal law as interpreted
y prior court decisions. In this case, no less than in others heard
with a full complement of attorneys, the decision should be "free from
he probability of prejudice" arising from extraneous circumstances.

CONCLUSION

his Pétition for Rehearing should be granted, the decision reversed,
nd a clarifying opinion of suitable length appended to the decision.

ated: September 4, 1968.

Respectfully submitted,

J. Howard Arnold
Appellant, pro se

No. 21,816

In the
United States Court of Appeals
For the Ninth Circuit

UNITED STATES OF AMERICA, for the use
and benefit of CHICAGO BRIDGE & IRON
COMPANY, an Illinois corporation,

Appellant,

vs.

ETS-HOKIN CORPORATION, a California cor-
poration, and THE TRAVELERS INDEMNITY
COMPANY, a Connecticut corporation,

Appellees.

Appellant's Opening Brief

FILED

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WM. B. LUCK, CLERK

RYLEY, CARLOCK & RALSTON
FRANK C. BROPHY, JR.

Title & Trust Building
Phoenix, Arizona 85003

Attorneys for Appellant

SEP 20 1967

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UNITED STATES OF AMERICA, for the use
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ETS-HOKIN CORPORATION, a California cor-
poration, and THE TRAVELERS INDEMNITY
COMPANY, a Connecticut corporation,

Appellees.

Appellant's Opening Brief

I.

JURISDICTIONAL STATEMENT

The Order and Judgment of the United States District Court for the Northern District of California entered in consolidated cause Nos. 44430 and 44552 on December 30, 1966 (TR 130-139) is the subject matter of this appeal,

notice of which, together with a cost bond on appeal in the sum of \$250.00 was filed on March 14, 1967 by Chicago Bridge & Iron Company (hereinafter referred to as CB&I) (TR 140, 141). A Designation of Contents of Record on Appeal and a Statement of Points were filed on March 14, 1967, and an order extending the time to docket the appeal to May 11, 1967 was secured on March 17, 1967. Accordingly, the appeal was docketed and the transcript of record filed in a timely manner. Jurisdiction of the District Court to hear and decide the consolidated cases is conferred by Sections 10 and 12 of the Federal Arbitration Act, Title 9, United States Code. The jurisdiction of this Court to determine this appeal is conferred by 28 USC Section 1291.

II.

STATEMENT OF THE CASE

Since this appeal has been consolidated with Appeal No. 21033 for Hearing before this Court by an order dated August 3, 1967, Appellant, in order to economize, hereby adopts the Statement of Facts set forth in its Opening Brief on file with the Court in Appeal No. 21033, adding thereto, however, the following pertinent facts.

The Order and Judgment appealed from herein is the Order, TR 130, and Judgment, TR 48, 49, of Judge Alfonso Zirpoli affirming an award of arbitrators entered on September 1, 1965, TR 125-128. The arbitration had been conducted and concluded pursuant to Appellee, Ets-Hokin's Demand for Arbitration, TR 33-35, and the order of the District Court for the District of Arizona, Judge Carl Muecke presiding, TR-36, granting said Appellee's Motion For Stay of Action Pending Arbitration dated August 20, 1964 (See Appeal No. 21033, Transcript of Record 6-18). The Motion requested a Stay of Appellant's Arizona District Court Action (see a copy of Appellant's original

Complaint, Appendix C) pending arbitration of the subcontract dispute in accordance with said Appellee's Demand for Arbitration dated August 14, 1964 under Paragraph 23 of the Subcontract, TR-21, between Appellant and Appellee, Ets-Hokin, dated August 22, 1962. The text of the Motion and Exhibits B and C thereto and Paragraph 23 of the Subcontract are reproduced in Appendix A herein for convenience of reference during the course of this Brief.

The proceedings in Cause Nos. 44430 and 44552 in the District Court below constitute an effort of the Appellant to have the Arbitration award vacated and set aside and an effort by the Appellee, Ets-Hokin, to have that award confirmed. Both efforts were based upon certain statutory provisions of Title 9 USCA, Sections 9, 10 and 11. The text of these sections is set forth in Appendix B of this Brief.

Briefly, the Appellant contended that the Arbitrators in making the award had exceeded their powers under Section 10(d) and, in addition, had either refused to hear evidence pertinent and material to the controversy, namely, the Appellant's analysis, TR 38-47, of the backcharges made by Appellee, Ets-Hokins, for prestressing, or having considered it, had materially miscalculated appropriate labor backcharges under Section 11(a) of the Federal Arbitration Act. The Appellees, Ets-Hokin Corp. and The Travelers Indemnity Company, sought judicial confirmation of the Arbitrators Award pursuant to Section 9 of the Federal Arbitration Act and Section 1285 of the California Code of Civil Procedure (see Appendix A and TR 116-118).

The District Court in its Order of December 30, 1966 found that the Arbitrators had not exceeded their powers in predicating their award upon matters outside of the writ-

ten Subcontract and that the Arbitrators did not miscalculate the backcharges since the conflicting evidence as to the backcharges was not before the Arbitrators in a verified form at the time they entered their Award.

III.

SPECIFICATIONS OF ERROR

The Order and Judgment of the United States District Court for the Northern District of California, the correctness of which Appellant submits to this Court for review, are in error as follows:

A. Specification of Error No. 1

The District Court erred in finding that the District Court of Arizona "merely" stayed proceedings in Appellant's lawsuit in that Court against Appellees "in accordance with the agreement of the parties", and did not restrict the issues submitted for arbitration.

B. Specification of Error No. 2

The District Court erred in finding that "the parties did not limit the issues to the Subcontract and the demand of August 14, 1964...".

C. Specification of Error No. 3

The District Court erred in finding that the Arbitration Board had merely used the parol evidence of Appellant's offer in the contract negotiations to furnish a standby operator during prestressing operations to "clear up ambiguity" under paragraph 1(b) of the Subcontract agreement which provided for Appellant to install the spiral cases with test barrel and spider.

D. Specification of Error No. 4

The District Court erred in finding that the Arbitration Board did not improperly compute the Award or that

unverified evidence compels the Court to accept the calculations of the Board as final upon the state of the record.

SUMMARY OF ARGUMENT

It is well established that the power of an Arbitration Board to make awards is limited to the issues submitted to it for decision by the parties. *Wright Lumber Co. v. Herron* 199 F2d 446 (CA-10 1952); *Gaddis Mining Co. v. Continental Materials Co.* 196 F.S. 860, 867 (D.C. Wy. 1961); *Bierlein v. Johnson* 166 P2d 644 (California—1946). The principal issue submitted to the Arbitrators for decision was the question of whether Appellant in failing to perform the prestressing work defined in subparagraph 208(g) of the General Contract Specifications, breached or defaulted in its obligations under the Subcontract of August 22, 1962 between Appellant and Appellee, Ets-Hokin.

Under the paragraph 1(b) of the Subcontract, the Appellant was to install the Glen Canyon dam powerhouse turbine spiral cases together with a test barrel and spider. The Arbitration Board found that during the course of subcontract negotiations Appellee had made an oral offer to furnish a standby operator to maintain pressure during the prestressing of the spiral cases. The Board further found that this offer to furnish a standby operator was made by Appellant in order to induce the Appellee, Ets-Hokin to award it the subcontract which was then being negotiated. The Board then found that Appellant should be bound by its oral offer, even though the same was not accepted by the written Subcontract. Accordingly, the Board entered an Award which charged Appellant for one-half of the labor cost of a standby operator, having also found that the said operator would also be responsible for maintaining the proper temperature during the prestressing period, and that the obligation to maintain the correct temperature was not a part of the prestressing.

The decision of the Arbitrators imposed an obligation upon the Appellant which was not to be found in the written Subcontract or upon any reasonable interpretation of its terms, and accordingly constitutes the imposition upon Appellant of an obligation independent of and collateral to the Subcontract. The Appellant submits that the Arbitrators were not called upon to decide whether Appellant was guilty of the breach of an independent collateral "agreement", but only whether it was guilty of a breach of the written Subcontract, and that in making such a decision, they determined a matter not submitted to them, thereby exceeding their powers under Section 10(a) of the Federal Arbitration Act.

The lower court found that the parties had broadened the issues to be arbitrated to include the intent and understanding of the parties other than as set forth in the Subcontract of August 22, 1962. In addition, the lower court *appeared* to justify the Arbitrator's Award upon the grounds that it constituted no more than the finding of an implied covenant under the Subcontract dated August 22, 1962. The Appellant argues against the findings of the lower court upon the grounds that the court ignored Appellant's insistence throughout the proceedings upon the proper application of the parol evidence rule; that Appellant never consented to a broadening of the issues beyond the Subcontract of August 22, 1962; and that the findings of the Arbitration Board on their face and under the rules governing the creation of implied covenants, did not constitute the finding of an implied covenant under the Subcontract binding the Appellant to furnish a standby operator for prestressing.

Additionally, the Appellant argues against the summary dismissal by the Lower Court of Appellant's contention that the Award was defective under Section 10 or 11 of the Federal Arbitration Act, for the reason that the issue of

the proper amount of backcharges was properly before the Board; that the Board had committed itself to a resolution of the issue prior to making an Award; and that its failure to do so renders its Award defective since the discrepancies in payroll figures constituting the backcharges are real and not imaginary.

ARGUMENT

Specification of Error No. 1.

A. The District Court stayed proceedings before it pending arbitration only of those issues raised in the demand for arbitration.

The District Court of Arizona's minute entry for October 26, 1964, TR 36, sets forth the Order of that Court staying Appellant's action under the Miller Act, 40 USC 270, against Appellees, in the following language:

"It is ordered that Defendant's Motion for Stay of Action pending arbitration is granted *only as to specific items raised in the motion*, subject to either party coming back to the court for relief by reason of any delay in such arbitration". (Emphasis added)

What were the "specific items raised in the motion"? The Motion for Stay of Action recited on its face in Paragraph 2 thereof that the lawsuit brought by Appellant involved "a dispute between the parties as to the interpretation of the subcontract" and that Appellee Ets-Hokin had, subsequent to the filing of the lawsuit, requested Appellant to arbitrate the dispute under Paragraph 23 of the subcontract. The Motion asked for a stay of the Appellant's action "until an arbitration shall be had in accordance with the terms of the subcontract entered into between" the Appellant and Appellee Ets-Hokin.

Appellee Ets-Hokin's letter demanding Arbitration, TR-33, refers to an arbitration of "the disputes hereinafter referred to" and then proceeds to outline six issues, the principal one of which was stated to be:

"Whether Chicago Bridge & Iron Co. breached its obligations under the subcontract by failing and refusing to perform that portion of Item 79 of the Bidding Schedule for Specifications No. DC-5750 of the United States Government Contract No. 14-06-D-4429, described in Paragraph 208 of said Specification, namely, the cooling and prestressing of the Spiral cases for the turbine units, Nos. 1 through 8 of the power house at the Glen Canyon Dam Project, which work was a part of the said Subcontract." (TR-34).

The remaining issues were subsidiary and dependent upon the resolution of the above issue. Thus, when the District Court of Arizona stated that it was staying Appellant's lawsuit to permit arbitration of the specific items raised by the Appellee's Motion to Stay, the court was referring to the dispute between the parties as outlined in six parts by Appellee Ets-Hokin's demand letter of August 14, 1964.

To dismiss this limitation upon the arbitration proceedings by declaring that the arbitrators were not bound by it since their authority was derived from Article 23 of the Subcontract is to ignore the realities of the dispute between the parties.

Appellants did not wish to have their Miller Act rights determined by arbitration and strongly resisted Ets-Hokin's Motion For Stay of Action. It was Appellant's counsel who requested the District Court to limit the Stay of proceedings in the lawsuit for arbitration only of those issues raised by the Motion. Consequently, the underlined language in the Court's order cited above was added to the order in an effort to limit the scope of the arbitration. What the Court for the Northern District of California now appears to be saying is that the Arizona District Court does not have the power to restrict the scope of the arbitration. Appar-

ently, the District Court has the power to deny the Motion For Stay of Action, but not the power to limit or restrict the arbitration at the instance of one of the parties.

Further, the District Court for the Northern District found that since the Arizona District Court did not direct the parties to arbitrate, it did not, therefore, restrict the arbitrators authority. Such reasoning miscasts the issue of whether the arbitrators had the power to make the decision they made in this instance. It can be granted that the arbitrator's power to arbitrate is not derivative from the Court's fiat without concluding, thereupon, that therefore the arbitrators had the power to arbitrate any dispute or issue put to them by any *one* of the parties.

When it is remembered that Appellant resisted arbitration and would not have engaged in the arbitration at all without the Court's Order, it is nonsense to state that Appellant would have been obliged without further judicial action to arbitrate disputes not agreed to be arbitrated by it or included within the scope of the Court's Order. Appellant was obligated, under the Court's Order, to arbitrate only the issues referred to by the Court or such other issues as it agreed to arbitrate. Had Appellee Ets-Hokin wished to arbitrate issues not within the scope of the Court's Order or not agreed to by Appellant, it would have had to apply to the Court for a determination on the matter, unless it could have acquired the consent of the Appellant.

While Section 3 of the Federal Arbitration Act refers only to a stay of court proceedings pending arbitration, Section 4 of the Act provides for authority to compel parties to an arbitration agreement to arbitrate. Thus, had Appellant refused, after the Arizona District Court's Stay Order of October 26, 1964, to arbitrate the issues set forth in the Demand letter of August 14, 1964, Appellee Ets-Hokin could have proceeded under Section 4 of the Act to compel the

arbitration, and such action was no doubt contemplated by the last part of the Arizona Court's Order. Thus, the Arizona Court's Order, read in the light of Sections 3 and 4 of the Arbitration Act taken together, clearly constitutes a mandate, even if only implicit, that Appellant arbitrate the issues referred to in the Motion, i.e., the six issues set forth in the letter of August 14, 1964.

Finally, the Arizona Court's Stay order certainly can be construed as pertinent to a determination of the issues submitted to the arbitrators for decision. As decided by the Court in *American Almond Products Co. v. Consolidated Pecan Sales Co.* 144 F2d 448, 449 (2 Cir. 1944), the issue of whether the arbitrators exceeded their powers within the meaning of subdivision 10(d) of the Arbitration Act depends upon whether the submission of issues to arbitration admits of or requires the arbitrators to decide whether, upon grounds other than the terms and provisions of the written Subcontract, Appellant was required to perform the prestressing of the spiral cases. Certainly, as of the date of the Arizona District Court's Stay Order of October 26, 1964, no such consideration was required of the Arbitrators. The issue at that time was strictly: Did the written Subcontract of August 22, 1962 require the Appellant to perform the prestressing work as described in subparagraph 208(g) of the General Contract Specifications? In Staying the Appellant's civil action before it, the Arizona Court implicitly decided that this issue was referable to arbitration under Paragraph 23 of the said Subcontract, and that, accordingly, proceedings in the civil action would be stayed to allow for arbitration of this issue.

Specification of Error No. 2.

A. Appellant, at no time, agreed to or acquiesced in the arbitration of the issue of whether it obligated itself outside of the terms and provisions of the Subcontract of August 22, 1962 to provide a standby operator for the prestressing of the spiral cases.

Throughout its dispute with Appellee Ets-Hokin, Appellant has steadfastly maintained that in executing the Subcontract of August 22, 1962, it was not obligating itself in any way to perform the cooling or prestressing duties set forth in Paragraph 208(g) of the Contract Specifications. Up until the Arbitration Award, it was also Appellant's understanding that Appellee Ets-Hokin considered the prestressing at least to be an obligation of the Appellant under the said Subcontract. The arbitrators agreed with the Appellant's understanding of the said Subcontract, but, nevertheless, found that Appellant should have, at least, furnished a standby operator for the prestressing because of an oral offer made during the course of contract negotiations (see TR 126, Par. 8; and Transcript of Arbitration Proceedings pages 77-89).

Appellant's now learn, to their dismay, that what was being arbitrated was not just the obligations of the parties as expressed in the various documents making up the written Subcontract agreement of August 22, 1962, but also any obligations, moral, legal or equitable, which the arbitrators deem to have been created during the give and take of subcontract negotiations. The arbitrators could not find in the written Subcontract any acceptance of the Appellant's offer during negotiations to furnish a standby operator, nevertheless, they felt that a properly drawn subcontract should have contained such an item, because of conversations between the parties during subcontract negotiations, and therefore, they were going to set matters right by, in effect, rewriting the Subcontract agreement. And, to sustain this expression of justice, the District

Court below appears to have resorted to the fiction that the issues submitted for arbitration had been broadened by the parties themselves to include any agreements or understandings the parties may have had collateral and prior to the execution of the Subcontract agreement. Appellants are not sure this is precisely what the lower court is saying in its opinion, but if it is, then it is wrong and a gross misinterpretation of Appellant's position on the issues throughout the arbitration proceedings.

The whole legal justification for Appellant's refusal to perform any cooling or prestressing was based on the fact that work was not a part of the written Subcontract. It had sued the Appellee Ets-Hokin on this premise in an effort to recover back-charges. It had asked the Arizona District Court, faced with the inevitability of a Stay Order, to limit the arbitration contemplated by its Order to the Subcontract of August 22, 1962 in a further effort to preserve its asserted rights; and finally, at the outset of the arbitration hearings, it requested that the arbitrators concern themselves solely with the written Subcontract, and, if parol evidence was deemed necessary, that they consider it only as an aid to the interpretation of that Subcontract language which required an explanation of its meaning and intent (see transcript of Arbitration Hearings, Pages 12-16). Thus, to hold, as the District Court below did, that Appellant agreed, or consented, to a broadening of the issues so as to permit an Arbitration Award based on what the arbitrators may have conceived as being the intention of the parties separate and apart from the Subcontract, is an unreasonable interpretation of the Appellant's position throughout the course of arbitration.

The District Court below misrepresents the meaning of Appellant's Statement of the Issues to the Arbitration Board, TR-136, Lines 7-18.

Quoting from Appellant's Statement of Issues, TR 66-69, submitted to the arbitrators at their request prior to the Arbitration Hearing, the lower court concluded, that because Appellant argued for its interpretation of the written Subcontract language by declaring in its statement that "the Subcontract work was clearly *intended* and *understood* by the parties to be the work under Item 79, which was preliminary to CB&I subcontract work for the turbine manufacturer . . .", the Appellant, therefore, included among the issues to be discussed and determined by the Arbitrators the intention and understanding of the parties" apart from and outside of the written Subcontract. To draw such a conclusion from an Argumentative Statement of the Appellant, is to import a meaning or intent to those words which simply did not exist. When Appellant addressed the Arbitrators in its Statement of Issues to the effect that "installation of spiral cases as that term is used in the subcontract does not comprehend cooling and prestressing . . ." because "the subcontract work was clearly intended and understood by the parties to be that work under Item 79 which was preliminary . . ." to certain other work of the Appellant for another contractor, the Appellant, by no stretch of the imagination, was asking the Arbitrator to determine whether or not there were any other agreements between Appellant and Appellee Ets-Hokin other than those set forth in the Subcontract agreement.

By the very act of being called upon to construe a written agreement, the arbitrators were being asked to determine the *intent* and *understanding* of the parties as expressed in the written Subcontract. To place before the Arbitrators the issue of whether the intent and understanding of the parties as expressed in the written Subcontract comprehends prestressing, is not to submit to the Arbitrators the issue of whether there were circumstances existing during the course of Subcontract negotiations which in law, or in

equity, imposed an obligation upon the Appellant to do the prestressing, notwithstanding the intent or understanding of the parties as expressed in the terms and provision of the written Subcontract agreement.

The Arbitrators were not interpreting or construing the written Subcontract when they declared:

“That the oral offer of furnishing a stand-by operator by a responsible representative of Chicago Bridge and Iron Company to secure a contract should be as binding as the written word, as no evidence was presented of a written acceptance or refusal of this offer.”

(TR-126, par. 8).

Here, the Arbitrators were clearly adopting parol evidence produced at the Arbitration Hearing (Transcript of Arbitration Hearings, Pages 81-88), not for the purpose of interpreting or construing the Subcontract language, but for the purpose of imposing an obligation upon Appellant which, admittedly, they did not find in the Subcontract. From this point of view, it is precisely because of this misuse of parol evidence, that we have the Arbitrators making a decision upon an issue not submitted to them.

Again, the lower court cites language used by counsel for Appellant at the Arbitration Hearing (See TR-136 and p. 93, Transcript of Arbitration Proceedings) to justify its conclusion that the issue of whether Appellant was liable to Appellee Ets-Hokin, upon the basis of an oral offer made during the course of contract negotiation was an issue in the Arbitration proceedings. Counsel's remarks were made after it had become quite clear that the Arbitrators were going to receive parol evidence despite Appellant's objections to the effect that parol evidence was unnecessary to construe the Subcontract.

The language of Appellant's counsel cited by the lower court is as follows:

"I think what is before the Board is what the parties did after the Agreement, and what they did before the Agreement, for the purpose of the Board's making up its mind what the Agreement meant at the time that it was executed."

These remarks were made with specific reference to Paragraph 10 of the printed General Conditions of the Subcontract, which provided in pertinent part as follows:

"if Subcontractor fails to commence or to prosecute the work required hereunder promptly and diligently . . . Contractor shall have the right if it so elects and without prejudice to any other rights it may have, by giving written notice of its election to Subcontractor to take over all work, or any part thereof . . . and finish the work by whatever method it deems expedient . . . If Subcontractor fails to supply sufficient skilled workmen, suitable materials or adequate equipment, Contractor may, as an alternative to the foregoing remedy, and upon giving the notice above provided, furnish such labor (etc.) . . . and charge the entire cost of furnishing the same . . . to Subcontractor and deduct such costs from any amount payable to Subcontractor."

Appellant's counsel in questioning one of Appellant's witnesses had asked if, prior to Appellee Ets-Hokin's backcharge for prestressing, Appellant had received any written notice of said Appellee's intent to backcharge. The witness answered that no notice had been received. The provisions of Paragraph 10 above were then mentioned, and the witness was asked if the Appellant believed that Ets-Hokin had failed to comply with Paragraph 10. Ets-Hokin's counsel then objected to the questioning on the grounds that Ets-Hokin's compliance or non-compliance with Paragraph 10 was not an issue in the Arbitration, and counsel for Appellant responded to the effect that since parol evidence was being used to construe the Subcontract, the

subsequent actions of Appellee, Ets-Hokin, were relevant to a determination of its understanding of the Subcontract's terms at the time of its execution. In other words, if at the time of execution, Ets-Hokin intended, or understood, the written Subcontract to include prestressing, then, why, when Appellant refused to perform this work, did not Ets-Hokin give the notice required by Paragraph 10? The reference to Paragraph 10 was therefore intended to show that, contrary to its later statements, Ets-Hokin had not understood the Subcontract to include the prestressing obligation, and that its decision to backcharge for it was based upon a construction of the Subcontract arrived at after it had executed the Subcontract, entered into its performance, and discovered it had forgotten to provide for cooling and prestressing in its Subcontract.

Counsel's remarks, therefore, were intended to justify this reference to Paragraph 10 of the Subcontract, as a part of its use of parol evidence to construe the intent of the parties as expressed in the Subcontract. Counsel's remarks certainly do not justify the lower court's conclusion that the issues of the Arbitration were thereby broadened to include the issue contained in Paragraph 8 of the Arbitrator's decision, i.e., whether there was a binding oral agreement outside of the written subcontract.

There is a certain irony in the situation created by the lower court's opinion. The Appellant finds itself in the position of being told that it did the very thing it attempted to avoid throughout the Arbitration proceedings, namely, to expand the issues beyond the confines of the Subcontract document. Indeed, the very Statement of Issues cited by the lower court in support of its conclusion, contained a very precise Statement of the issues before the Board by the Appellant, to wit:

"The issues to be considered by this Board of Arbitration are as follows:

1. Was Prestressing of the Spiral Cases, as set forth in Paragraph 208(g) of Specifications No. DC-5750, an obligation of CB&I under that portion of Bid Item 79 of the Bidding Schedule incorporated into the subcontract between CB&I and Ets-Hokin dated August 22, 1962?

2. If prestressing of the spiral cases is determined to be a part of the CB&I subcontract work, then the Board must further determine:

(a)-----

(b)-----".(TR-69)

And, again, in a Hearing Brief submitted to the Arbitrators prior to the Hearing, Appellant, over and over, stressed to the Board that it must concern itself only with the issue of whether there had been a breach of the written Subcontract. For example:

"The first function of the Board, therefore, is to construe the subcontract of August 22, 1962, to read it and to determine, if, upon its face, it is clear and unambiguous, and requires no further explanation with respect to the issue of whether it required CB&I to carry out prestressing..." (TR-80).

"Since the primary duty of the Board is to determine what work the parties intended to cover as that intention is expressed in the language of the subcontract agreement, if that intent can be ascertained from the document itself, then the Board should not proceed to consider other evidence...". (TR-81).

* * * * *

"In utilizing evidence outside of the written contract for the purpose of determining the scope and meaning of the contract . . . the Board should keep in mind certain instructions which Courts have, over the years, generally deferred to in the construction of written agreements.

* * * * *

Rule II: The Board should make an effort to avoid either modifying the subcontract or creating a new one

Rule III: It, the Board, should not attempt to make a better or more equitable agreement for the parties if, in doing so, they would depart from the specific and clear language of the subcontract

These Rules are really one rule, the thrust of which is to advise the Board as follows: It is not your function to be nice "guys"! Your function is to enforce the agreement as it is written. If the agreement, as written, works out to be more advantageous to one party than the other, it is not your duty to try to balance the equities. In other words, if Ets-Hokin, intending to subcontract the prestressing duty, made an agreement which, by its terms cannot be construed to encompass prestressing, it is not your function to rewrite the contract, so that it does include the function of pre-stressing. If the contract makes sense when "install" is given its ordinary meaning of "to put in place", then, it is not up to you, the Board, to say that to "install" means "to embed" the spiral cases in concrete, or "to do all the work in the completion contract pertaining to spiral cases, in an effort to give Ets-Hokin some relief from its own shortcomings as a negotiator of subcontract work." TR-95, 96.

The irony becomes acute when it is seen that Ets-Hokin itself defined the principal issue in its Statement of Issues to the Board in terms of the written Subcontract, TR 70-76. For example, Ets-Hokin described the terms of the Subcontract pertinent to the prestressing requirement issue, and then declared:

"This refusal on the part of Chicago Bridge and Iron (to perform the prestressing) raises the first principal issue in this arbitration, namely, was Chicago Bridge and Iron Co. required by its said subcontract with Ets-Hokin to prestress the spiral cases for the eight turbines." (TR-72).

Specification of Error No. 3.

A. The Arbitrators did not find Appellant's oral offer of a standby operator to be an implied covenant or obligation of the Subcontract as inferred by the lower court.

The lower court reasoned that since the *intent* and *understanding* of the parties to the Subcontract was an appropriate consideration of the Arbitration Board, the latter's finding of no evidence of any agreement by Appellant to perform the prestressing was merely a finding of no express written covenant in the Subcontract, thereby inferring that the Board's finding under Paragraph 8 as to the oral offer of a standby operator, was a finding of an implied covenant or obligation.

The Board's judgment was that the evidence before it indicated that CB&I did not agree to perform the prestressing work. This is clearly a statement that neither the subcontract nor the extrinsic evidence presented to the Board confirms an agreement by CB&I to do the prestressing. Thus, the Board is finding that even the oral offer to furnish the standby operator did not constitute an agreement by CB&I to perform an act under the Subcontract.

However, the fact remains that in Paragraph 11 of the Award, the Board found that CB&I should have performed the prestressing, at least to the extent of providing a standby operator; and the reason for this conclusion is set forth in Paragraph 8 of the Award, to wit:

"That the oral offer of furnishing a stand-by operator by a responsible representative of Chicago Bridge and Iron Company to secure a contract should be as binding as the written word."

Thus, it is not by virtue of any construction of the written Subcontract that the Board is imposing the obligation to prestress upon CB&I, but solely upon the grounds that since

the prestressing was a requirement of the General Contract under the Specifications thereto, TR 125, Par. 6, and since CB&I had, in an effort to secure the contract, orally offered to furnish a standby operator, it, therefore, should be required to do that which at one time it had offered to do.

This is not the use of parol evidence to construe the intent and understanding of the parties as expressed in writing in a Subcontract agreement. This is the use of parol evidence to establish a prior equitable or moral commitment on the part of the Appellant in the nature of an estoppel, even though there was no evidence before the Arbitrators to show that either Appellee's Mr. Bruni, who agreed to the Subcontract, or Appellee's Mr. Lauter, who actually executed the Subcontract, had accepted the oral offer or relied upon it in agreeing to or executing the Subcontract.

Rather than find that the Appellant had agreed under the contract to perform the prestressing, the Board specifically found that the Appellant had expressly excluded many of the duties making up the prestressing obligation as described in subparagraph 208(g) of the General Contract Specifications. In Paragraph 9 of the Award, TR 126, the Board found that CB&I had specifically excluded the installation of any gates, valves, small pipes and other appurtenances. Prestressing calls for the installation of a pressure system which requires the installation of "gates, valves, small pipes and other appurtenances". One cannot find an implied covenant to a written agreement where the express terms of that agreement give rise to an opposite inference.

"It is only where the expressed contract is silent on a particular point that an implied obligation in such respect can arise. No meaning, terms or conditions can be implied which are inconsistent with the ex-

pressed conditions.” 17 AM Jur 2d *Contracts* Sec. 255, p. 652.

The express terms of the Subcontract rule out the performance of part of the prestressing obligation, therefore, no implication can arise from the writing itself that the parties contemplated or impliedly agreed that CB&I should perform the balance of the prestressing obligation, i.e., the furnishing of a standby operator to watch and maintain the pressure in a pressure system to be installed by Ets-Hokin.

To qualify as an implied covenant or obligation of the Subcontract, acceptance of the oral offer to furnish a standby operator must be implicit in the language of the subcontract as it sets forth and expresses the intention and understanding of the parties thereto. Implied covenants are not favored in the law. *Walnut Creek Pipe Distributors, Inc. v. Gates Rubber Company Sales Division Inc.* 39 Cal. Rptr. 767 (1964) “and courts will declare the same to exist only when there is a satisfactory basis in the express contract of the parties which makes it necessary to imply certain duties and obligations in order to effect the purposes of the parties to the contract made”. *Cousins Inv. Co. v. Hastings Clothing Co.* 45 Cal. App. 2d 141 at 143, 113 P.2d 878 at 879.

“The Courts cannot make better agreements for the parties than they themselves have been satisfied to enter into or rewrite contracts because they operate harshly or inequitably. It is not enough to say that without the proposed implied covenant, the contract would be improvident or unwise or would operate unjustly.”

Walnut Creek Pipe v. Gates Rubber Co. . . . *supra* at 771.

Thus, even had the arbitrators intended to define an implied covenant to the written contract to furnish a standby operator, the normal rules governing the creation of an implied covenant would not permit them to do so in this instance.

But the arbitrators were not so sophisticated as to raise up an implied covenant. The Board was merely expressing its sense of justice, declaring that if CB&I, during the course of contract bargaining, made an offer to perform a certain portion of the general contract as part of an effort to induce the award to it of a subcontract, then it should be bound by the offer. This is a case of the use of parol evidence not to interpret or construe a subcontract, but to impose upon CB&I an obligation separate and apart from the subcontract.

B. The Arbitrators have no power to expand the scope of the Arbitration without the Agreement of the Parties.

The lower court pointed to the informal questions submitted by Arbitrator Corwin to the parties prior to the Arbitration Hearings as an example of the broadened scope of the issues submitted to the Arbitrators for decision. In particular, the Court noted that Mr. Corwin asked: "Was there any discussion between Contractor and Subcontractor about who would perform the prestressing work?", and both parties answered this question. The fact that Appellant answered this question cannot be construed either (1) as a broadening of the issues to include the question of whether Appellant made a binding promise outside of the written Subcontract to perform certain work, or (2) as a consent to or acquiescence by the Appellant to a broadening of the issues presented to the Arbitration Board for decision.

The Arbitrator's questions were in the nature of discovery, a process which permits a wide range of questions without prejudice to the litigating parties. However, to impute to this question the power of broadening the submission of issues to the Board is to give it a power which it does not possess inherently and which would probably surprise even the questioner himself.

To confer upon a question asked in the course of an arbitration the power to alter the subject matter of the arbitration would render the arbitration process perilous to the point of inutility.

The power of the Arbitrators to decide issues rests upon the consent of the parties. 3 AM Jur, *Arbitration and Award Section 10*; *Lundgren v. Freeman*, 307 F2d 104 (C.A. 9, 1962), albeit even a judicially compelled consent as in this case. If the parties do not knowingly consent to the arbitration of a specific issue, the Arbitrators simply do not have the power to determine this issue and make an Award upon it. Thus, historically, Arbitrators have no authority to deviate from their instructions or "the submission" *McCormick v. Gray* 54 U. S. 23 (1851), and their Award may be set aside if they exceed their authority. *United States v. Farragut* 89 U. S. 406 (1874).

- C. The dissent of Arbitrator Elsener rather than support the lower court's conclusion of an implied covenant to prestress in the Subcontract, scores the fact that the Board did not find an implied covenant but a prior obligation separate from the subcontract.**

The lower court found that the dissenting arbitrator confirmed the Court's conclusion to the effect that the parties intended for Appellant to do the prestressing work. What Arbitrator Elsener in fact said, when taken in total context, is that the majority of the Board found that in making an oral offer to furnish a standby operator during prestressing operations, the Appellant agreed to do the

prestressing work. If they agree to do the work, as Elsener characterized the Board's decision, then they, the Board, should have found that Appellant ought not to have been backcharged for premium overtime. Elsener's observation merely highlights the fact that the Board was making a finding of an obligation which it did not consider to be a part of the Subcontract. Had it been an agreement under the Subcontract, the Board should have made allowance for the overtime backcharges. Mr. Elsener's characterization of the Board's finding in this respect is more adequately set forth in the first paragraph of his dissent:

"The finding that an oral offer made by Chicago Bridge & Iron Company to Ets-Hokin to furnish a standby operator should be binding on Chicago Bridge is incorrect. That offer was not accepted by Ets-Hokin either orally or in writing. It has never been my understanding that a party is bound by an unaccepted offer. The offer made by Chicago Bridge was made when it was asking a much higher price, and when the price was reduced I would expect a change in the definition of work as well. Ets-Hokin defined the work when it wrote the contract, and it could easily have provided expressly for Chicago Bridge to do the prestressing, if that had been the agreement. To find that a party shall be bound by a verbal offer made during the usual give and take of contract negotiations where that offer was not referred to again and was not covered by the written contract makes it futile to reduce a contract to writing." (TR-129)

And, indeed, the Award of the Board does show the futility of reducing the intention and understanding of the parties to a writing when the writing, and all reasonable interpretations thereof can be ignored, and a party be held to answer for prior oral offers which were never accepted.

D. The Arbitrators Award constitutes a clear violation of the parol evidence rule, which is merely another way of saying that the Arbitrators exceeded their power.

The lower court has said that the issues before the Arbitrators were broadened to include the intention and understanding of the parties, meaning thereby, apparently, the intention and understanding of the parties separate and apart from the Subcontract agreement. In this, as previously pointed out, the lower court was in error. In referring to the intention and understanding of the parties, Appellant was at all times throughout the proceedings referring to this intention and this understanding as set forth in the Subcontract agreement. This is the reason for Appellant's continuous insistence for strict adherence to the parol evidence rule throughout the Arbitration Hearing and in its memorandums to the Arbitration Board. Under that rule, parol evidence is intended only to explain the intention and understanding of the parties with reference to the written Subcontract.

"It must be kept in mind, however, that the only purpose for which such evidence is ever admissible in an action on the contract is to interpret the writing. So far as the evidence tends to show not the meaning of the writing, but an intention wholly unexpressed in the writing, it is irrelevant."

Williston on Contracts, Revised Student Edition,
Baker Voorhis & Co. 1938, page 499.

Thus, evidence of the prior negotiations of the parties is generally inadmissible where a written subcontract is deemed to have merged all prior oral agreements, as in the instant case. Paragraph 27 of the General Conditions of the Subcontract states:

"This Subcontract contains all covenants, stipulations and provisions agreed upon by the parties. No agent of either party has authority to make and the parties

shall not be bound by nor liable for any representation promise or agreement not set forth herein. No changes, amendments or modifications of the terms hereof shall be valid unless reduced to writing and signed by the parties."

Thus, the written Subcontract is intended to be a complete integration of the parties' agreement. A prior oral "agreement" therefor is not admissible to show the existence of an independent collateral obligation. It is admissible only to show that the words of the written subcontract bear a particular meaning. *Williston on Contracts*, supra p. 500-01. But the Arbitrators did not find that Appellant's prior oral offer to furnish a standby operator was a part of Appellant's obligation under the written Subcontract to install the spiral cases with test barrel and spider. Instead, they used this parol evidence to find an independent collateral obligation, and, it is precisely because of this that Appellant's say that the Arbitrators exceeded their powers. They were asked to interpret the Subcontract in order to determine if Appellant's refusal to perform the prestressing was a violation of its terms. They did not find that the Subcontract imposed the prestressing obligation on the Appellant; rather they found a prior independent collateral offer by the Appellant which they determined committed the Appellant to furnish a standby operator.

Specification of Error No. 4.

- A. The Arbitrators improperly computed the allowable backcharges in that they failed to consider or allow for the evidence submitted by Appellant on the issue of Wages for Standby Operators.**

Toward the end of the Arbitration Hearings (Transcript of Arbitration Hearings, p. 276-290, Vol. II), Appellant introduced Ets-Hokin payroll records filed with the Bureau of Reclamation for the period covered by the backcharge

invoices. The purpose of submitting these documents (Exhibit 85 in the Arbitration Hearing) was to demonstrate that Ets-Hokin's backcharge invoices contained employee time records for prestressing which did not match the Ets-Hokin time records for the same employees that were filed with the Federal Government. In other words, time records filed with the government would show that Ets-Hokin employee "A" worked four hours of regular time and two hours of overtime on a certain day, whereas, the backcharge invoice would contain a labor charge showing that on that certain day, the same employee worked four hours regular time and six hours overtime. In preparing Exhibit 85, Appellant's counsel had found some 636 hours of such discrepancies. Prima facie, at least, the documents indicated that Ets-Hokin was overcharging the Appellant in its backcharges. The government records submitted by Appellant were incomplete in that they did not cover all of the relevant backcharge invoices. Appellant did not submit government payroll records for labor charges in connection with the prestressing of Units 3 and 4 in the Glen Canyon Powerhouse.

Appellee's counsel was given an opportunity to examine these records before Appellee's witness, Barna, was cross-examined with respect to their contents. During cross-examination, the discrepancies were explained by the Ets-Hokin Arbitrator, the witness and the counsel for Appellee, as being the result of an IBM system, which required all premium, or overtime, labor to be reflected as regular time, so that the IBM machine could make out the payroll checks. However, this explanation did not clear up the discrepancies. Therefore, Mr. Murphy, the Ets-Hokin Arbitrator, suggested the following:

“Could we resolve it this way, Mr. Brophy, that your people and the Ets-Hokin people get together and reconcile these differences and then just let the Board know that there either is or isn’t a discrepancy?”

(Arbitration Transcript, P. 289)

This suggestion was accepted by both sides. Subsequent to the Hearing, the payroll records were more thoroughly analyzed by the Appellant, and the conclusion reached that the discrepancies did need further explanation. On August 26, 1965, the Appellant’s analysis of the payroll was forwarded to Arbitrator, L. A. Elsener, TR 38-47, for examination by the Board with the suggestion that the amounts involved were substantial enough to bear further inquiry by the Board. On September 1, 1965, the Board entered its Award, reflecting therein that the Board had not considered the discrepancies in payroll amounts which, according to CB&I, totaled at least \$2,662.08, TR-39, exclusive of the backcharges for Turbines 3 and 4; or, if the Board considered Appellant’s evidence, it chose to disregard it in its computation of allowable backcharges.

This disregard, or failure, of the Board constitutes, in Appellant’s opinion, a substantial defect in the Award. It means that in calculating the applicable backcharges, the Board did not chose to recognize or resolve evidence which demonstrated on its face substantial error in Appellee’s figures.

The lower court simply dismissed this contention of the Appellant by stating that since the evidence was never submitted to the Arbitrators in any verified form, the Arbitrators were, impliedly, under no obligation to consider it, TR-139. Originally, the evidence had been submitted without challenge as to its authenticity. Only its meaning or interpretation was in question, and this was to be worked out between the parties, if possible. The opportunity was never afforded the parties. The Award

was entered before the payroll evidence could have been properly examined by either the Board, or the Appellee. This deficiency should be corrected. Section 11(a) of the Federal Arbitration Act provides for a modification or correction of the Award where there was an evident material miscalculation of figures. Also, Section 10(c) of the Act calls for vacation of the Award where the Arbitrators refuse to hear evidence pertinent and material to the controversy. The record is not clear whether there was merely a miscalculation by or a failure of the Arbitrators to give due consideration to the problem raised by government payroll records. For the Award to be complete this problem should be resolved.

CONCLUSION

1. The Arbitrators exceeded their power in basing their Award upon an oral offer made by the Appellant prior to the conclusion of the negotiations and the execution of the Subcontract in question where there was no showing that the Subcontract required the performance of the offer for its own performance or could otherwise be construed to contain within its terms the obligation to furnish a standby operator.

2. Because the Board exceeded their power thus, in making their Award, the Award should be set aside and the Board directed to award the relief requested by the Appellant.

3. The Board further committed error in computing the backcharges by failing to take into account or consider the Appellant's evidence of overcharges by the Appellee Ets-Hokin.

Respectfully submitted,

RYLEY, CARLOCK & RALSTON

By FRANK C. BROPHY, JR.

Attorneys for Appellant

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

FRANK C. BROPHY, JR.

(Appendices Follow)

Appendix A

23. **ARBITRATION:** In case of any dispute between the parties as to the interpretation of this agreement, or as to a change in the Subcontract price or Subcontract time due to the issuance of a change order, or with respect to any other matter arising out of or in connection with this Subcontract or its performance, either party may demand that the dispute be submitted to arbitration. The demand shall be in writing, shall be served on the other party and shall specify the arbitrator chosen by the party making the demand. Within 7 days after receipt of the demand, the other party shall appoint an arbitrator, by written notice served on the party making the demand. The two arbitrators so chosen shall select a third arbitrator. The decision of any two arbitrators shall be binding and conclusive on the parties, shall be in writing and shall be a condition precedent to any right of legal action. In no case shall submission of a matter to arbitration be a cause for delay or discontinuance of any part of the work. Each party shall bear the expense of its own arbitrator, and the expense of the third arbitrator and other costs of the arbitration shall be divided equally between the parties.

Feldman & Waldman
 2002 Russ Building
 San Francisco, California
 YUkon 1-1300

Langerman & Begam
 800 Central Towers
 Phoenix 4, Arizona
 AMhurst 4-4171

*Attorneys for Defendants
 Ets-Hokin Corporation and
 The Travelers Indemnity Co.*

*In the United States District Court
 for the District of Arizona*

PRESCOTT DIVISION

No. Civ. 917 Pet.

United States of America, for the use and benefit of Chicago Bridge & Iron Com- pany, an Illinois corporation,	Plaintiffs,
--	-------------

vs.

Ets-Hokin Corporation, a California cor- poration, and The Travelers Indemnity Company, a Connecticut corporation,	Defendants.
--	-------------

MOTION FOR STAY OF ACTION PENDING ARBITRATION

Defendants move this Court to stay the above-entitled action and all proceedings herein until an arbitration shall be had in accordance with the terms of the subcontract entered into between the use-plaintiff and defendant ETS-HOKIN CORPORATION.

For grounds of this motion the defendants respectfully represent to this Court as follows :

1. On August 22, 1962, the use-plaintiff entered into and signed a subcontract with defendant Ets-Hokin Corporation, a photostatic copy of which is attached hereto and marked Exhibit "A". The subcontract is in respect to a transaction involving commerce. Article 23 of the General Conditions thereof provides for an arbitration in the event of any dispute between the parties as to the interpretation of the subcontract, or with respect to any other matter arising out of or in connection with the subcontract or its performance.

2. On July 7, 1964, the use-plaintiff instituted the above-entitled action for recovery under the Miller Act. The action involves a dispute between the parties as to the interpretation of the subcontract.

3. On August 14, 1964, by registered mail, return receipt requested, defendant Ets-Hokin Corporation sent a letter to use-plaintiff, a copy of which is attached hereto and marked Exhibit "B," referring to the arbitration clause of the subcontract and requesting an arbitration in accordance therewith. As of the date of filing this motion, use-plaintiff has not responded to said demand for arbitration.

4. Defendants, in support of this motion, have attached hereto Exhibits "A" and "B," as above, and the affidavit of Robert S. Lauter, Executive Vice President of defendant Ets-Hokin, which affidavit is attached hereto and marked Exhibit "C."

WHEREFOR, defendants herein pray that an order be entered by this Court staying the above-entitled action and all proceedings herein until an arbitration shall be had in accordance with the terms of the subcontract entered into

between the use-plaintiff and defendant Ets-Hokin Corporation.

Dated: August 20, 1964.

FELDMAN & WALDMAN

By /s/ LAURENCE N. WALKER
Laurence N. Walker

LANGERMAN & BEGAM

By /s/ MARK I. HARRISON

*Attorneys for Defendants
Ets-Hokin Corporation and
The Travelers Indemnity Co.*

Copy of the foregoing
delivered this 21 day of
August, 1964 to:

Ryley, Carlock & Ralston
519 Title & Trust Building
Phoenix, Arizona

LANGERMAN & BEGAM

By /s/ MARK I. HARRISON

EXHIBIT B

ETS-HOKIN CORPORATION [Letterhead]

551 Mission St., San Francisco 5, Calif.

Registered

Return Receipt Requested

August 14, 1964

Chicago Bridge & Iron Co.
550 West 17th South Street
Salt Lake City 10, Utah
Attention : Mr. J. G. Daniels

Gentlemen :

This letter constitutes a Demand for Arbitration of the disputes hereinafter referred to arising under the Subcontract between Ets-Hokin Corporation (formerly Ets-Hokin & Galvan, Inc.) and Chicago Bridge & Iron Co., dated August 22, 1962. This demand is made in accordance with Article 23 of the General Conditions of the said Subcontract.

In accordance with said Article 23, Ets-Hokin Corporation hereby informs you that the arbitrator chosen by it is Mr. J. Philip Murphy, whose address is P. O. Box 4335 Bayshore Station, Oakland, California, 94623.

You will note that under the terms of said Article 23 you are required within seven (7) days after your receipt of this Demand to appoint an arbitrator and to serve written notice of the same, identifying your arbitrator, upon Ets-Hokin Corporation.

The disputes as to which Ets-Hokin Corporation demands arbitration are as follows :

1. Whether Chicago Bridge & Iron Co. breached its obligations under the said Subcontract by failing and refusing to perform that portion of Item 79 of the Bidding Schedule for Specification No. DC 5750 of United States Government Contract No. 14-06-D-4429, described in para-

graph 208 g. of said Specification, namely, the cooling and prestressing of the spiral cases for the turbine units, Nos. 1 through 8, of the power house at the Glen Canyon Dam Project, which work was a part of the said Subcontract.

2. Whether as a result of the aforescribed breach, Ets-Hokin Corporation was entitled under the law and the terms of said Subcontract to do the aforescribed work and charge the cost to Chicago Bridge & Iron Co.

3. Whether the method used by Ets-Hokin Corporation for doing the said work was reasonable and not in excess of that required.

4. Whether the charges made by Ets-Hokin Corporation against Chicago Bridge & Iron Co. for doing such work were just and reasonable.

5. Whether either Ets-Hokin Corporation or Chicago Bridge & Iron Co. breached its respective obligations under said Subcontract in any other respect.

6. All disputes which are or may by amendment become the subject of Civil Action No. 917 PCT., now pending in the United States District Court, District of Arizona.

Ets-Hokin Corporation will seek a ruling from the arbitrators on all of these disputes.

Very truly yours,

ETS-HOKIN CORPORATION

By ROBERT S. LAUTER

Executive Vice President

cc: Ryley, Carlock & Ralston

519 Title and Trust Building

Phoenix, Arizona

Chicago Bridge & Iron Co.

P. O. Box 4416

Chicago, Illinois 60680

Attention: Mr. H. J. Clarke, President

Appendix
EXHIBIT "C"

7

Feldman & Waldman
2002 Russ Building
San Francisco, California
YUkon 1-1300

Langerman & Begam
800 Central Towers
Phoenix 4, Arizona
AMhurst 4-4171

Attorneys for Defendants
Ets-Hokin Corporation and
The Travelers Indemnity Co.

In the United States District Court
for the District of Arizona

PRESCOTT DIVISION

No. Civ. 917 Pct.

United States of America, for the use and benefit of Chicago Bridge & Iron Com- pany, an Illinois corporation,		Plaintiffs,
--	--	-------------

vs.

Ets-Hokin Corporation, a California cor- poration, and The Travelers Indemnity Company, a Connecticut corporation,		Defendants.
--	--	-------------

AFFIDAVIT OF ROBERTS S. LAUTER, EXECUTIVE
VICE PRESIDENT OF DEFENDANT ETS-HOKIN
CORPORATION

Robert S. Lauter, being duly sworn, says:

1. I am the Executive Vice President of Ets-Hokin Corporation, a defendant herein. On August 14, 1964, I served upon Chicago Bridge & Iron Co., use-plaintiff herein,

by United States mail, registered, return receipt requested, a demand for arbitration of certain disputes arising out of an agreement of subcontract between use-plaintiff and defendant Ets-Hokin Corporation. Said subcontract is attached to use-plaintiff's complaint as Exhibit "A" thereto and to defendants' motion for stay pending arbitration as Exhibit "A" thereto.

2. Ets-Hokin Corporation is a California corporation with its principal place of business in the State of California. Use-plaintiff Chicago Bridge & Iron Company is an Illinois corporation with its principal place of business in the State of Illinois.

3. Ets-Hokin Corporation's prime contract with the United States Bureau of Reclamation in the approximate amount of \$7,891,271.70 called for it to construct the powerhouse, install the turbo-generators, and construct the switchyard at the Glen Canyon Dam, Page, Arizona. These facilities would serve to generate hydro-electric power from the harnessing of the Colorado River, an interstate waterway, and distribute it to Arizona, Utah, and probably, in the future, other states as well.

4. Under its subcontract, Chicago Bridge & Iron Company agreed to perform a portion of the work of installing the turbogenerators.

5. In connection with the work on the Glen Canyon Dam Powerhouse, Ets-Hokin Corporation, Chicago Bridge & Iron Company, and other contractors on the project sent numerous supervisory personnel from California and other states into Arizona; several out-of-state subcontractors

were utilized; and substantial amounts of equipment and supplies were required to be moved across state lines.

/s/ ROBERT S. LAUTER
Robert S. Lauter

Subscribed and sworn to before me
this 20th day of August, 1964.

/s/ HALLIE KELLER

Notary Public in and for the City and
County of San Francisco, State of California.
My commission expires on Nov. 17, 1965.

Appendix B**3. Stay or proceedings where issue therein referable to arbitration.**

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration. 9 USCA Sec. 3

9. Award of arbitrators; confirmation; jurisdiction; procedure.

If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court, then at any time within one year after the award is made any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title. If no court is specified in the agreement of the parties, then such application may be made to the United States court in and for the district within which such award was made. Notice of the application shall be served upon the adverse party, and thereupon the court shall have jurisdiction of such party as though he had appeared generally in the proceeding. If the adverse party is a resident of the district within which the award

was made, such service shall be made upon the adverse party or his attorney as prescribed by law for service of notice of motion in an action in the same court. If the adverse party shall be a nonresident, then the notice of the application shall be served by the marshal of any district within which the adverse party may be found in like manner as other process of the court. July 30, 1947, c. 392, Section 1, 61 Stat. 669. 9 USCA Sec. 9

10. **Same; vacation; grounds; rehearing.**

In either of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—

(a) Where the award was procured by corruption, fraud, or undue means.

(b) Where there was evident partiality or corruption in the arbitrators, or either of them.

(c) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.

(d) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

(e) Where an award is vacated and the time within which the agreement required the award to be made has not expired the court may, in its discretion, direct a rehearing by the arbitrators. July 20, 1947, c. 392, Section 1, 61 Stat. 669. 9 USCA Sec. 10

11. Same; modification or correcting; grounds; order.

In either of the following cases the United States court in and for the district wherein the award was made may make an order modifying or correcting the award upon the application of any party to the arbitration—

(a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.

(b) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.

(c) Where the award is imperfect in matter of form not affecting the merits of the controversy.

The order may modify and correct the award, so as to effect the intent thereof and promote justice between the parties. July 30, 1947, c. 392, Section 1, 61 Stat. 669. 9 USCA Sec. 11

*In the District Court of the United States
for the District of Arizona*

PRESCOTT DIVISION

Civil Action File No. 917 Pct.

United States of America, for the use and
benefit of Chicago Bridge & Iron Com-
pany, an Illinois corporation,

Plaintiffs,

vs.

Ets-Hokin Corporation, a California cor-
poration, and The Travelers Indemnity
Company, a Connecticut corporation,

Defendants.

COMPLAINT

Use plaintiff alleges:

I.

This action is brought under the terms and provisions of 40 U.S.C. 270 (otherwise popularly known as the Miller Act) and jurisdiction of this Court rests upon such legislative authority and the facts hereinafter alleged which place Use plaintiff's claim within the purview thereof.

II.

On or about August 22, 1962, Use plaintiff entered into a subcontract agreement with defendant Ets-Hokin Corporation, a corporation, (formerly known as Ets-Hokin & Galvan, Inc., a corporation), a copy of which, exclusive of

documents incorporated therein by reference, is marked Exhibit "A" for identification, attached hereto and made a part hereof.

III.

Under the aforesaid subcontract plaintiff has undertaken amongst other items of construction the installation, assemblage and welding of the upper and lower draft tube liners with pier noses and pit liners and the installation of the discharge ring, stay rings and spiral cases with test barrel and spider in connection with the construction of the powerplant, switchyard and appurtenant works at the Glen Canyon Dam at Page, Coconino County, Arizona by defendant Ets-Hokin Corporation, prime contractor under United States Department of The Interior, Bureau of Reclamation contract No. 14-06-D-4429.

IV.

The aforesaid subcontract specifically excluded from the area of Use plaintiff's responsibility in connection with Specification No. DC-5750 of the above contract No. 14-06-D-4429, "any excavation, grouting, concrete work, packing, cleaning or painting, coating, wrapping, felt, tar, electrical, mechanical, structural, turbine, machinery or other general contract work", as well as "the installation of any gates, valves, small pipes or other appurtenances."

V.

Use plaintiff has completed more than 93% of the aforesaid subcontract and is continuing to perform the same.

VI.

In keeping with the terms of said subcontract, Use plaintiff has been billing and receiving subcontract pay-

ments from defendant Ets-Hokin Corporation periodically as the subcontract work has progressed. However, as to sums due and payable and billed prior hereto, defendant Ets-Hokin Corporation, as of May 4, 1964, has retained therefrom and refused to pay to Use plaintiff the sum of \$33,167.41 on the grounds and for the reason that said sums represent "backcharges" by said defendant to cover costs of prestressing spiral cases for each hydraulic turbine unit of the said powerplant during the placement and curing of concrete around said spiral cases.

VII.

Use plaintiff is not responsible under its subcontract with said defendant for such prestressing, and therefore, such "backcharges" by said defendant are a breach by said defendant of the subcontract and constitute a wrongful retention by said defendant of monies now due and payable to Use plaintiff under the aforesaid subcontract.

VIII.

Defendant Ets-Hokin has indicated to Use plaintiff that it will deduct further "backcharges" for such prestressing from monies now due and payable and to become due and payable to Use plaintiff under the aforesaid subcontract, and Use plaintiff begs leave of the Court to amend this complaint to include such additional anticipated "backcharges" if and when they are so made by said defendant.

IX.

In compliance with the requirements of 40 USC 270, defendant Ets-Hokin Corporation, a corporation, as principal entered into a payment bond contract with The

Travelers Indemnity Company, a corporation, as surety, in the sum of \$2,500,000.00 for the protection of all persons supplying labor and material in the prosecution of the work provided for in the aforesaid Bureau of Reclamation Prime Contract No. 14-06-D-4429. Said bond was and is in effect at all times pertinent herein.

X.

Under the terms of the aforesaid bond, and pursuant to the provision of the said Miller Act, every person who has furnished labor or material in the prosecution of the work provided for in Bureau of Reclamation Contract No. 14-06-D-4429 and who has not been paid in full therefor before the expiration of a period of ninety days after the day on which the last of the labor was done or performed by him or material was furnished or supplied by him for which a claim is made, shall have the right to sue on the aforesaid payment bond for the amount unpaid at the time of institution of such suit and to prosecute said action to final execution and judgment for the sums justly due him.

XI.

More than ninety days have passed since Use plaintiff performed work and furnished material under the aforesaid subcontract for which it has not been paid, exclusive of defendant Ets-Hokin 10% retention rights, and since defendant Ets-Hokin Corporation has failed to make payment as is hereinabove more specifically alleged on account of said defendant's explicit refusal to pay that amount of money to Use plaintiff which said defendant wrongfully retains as alleged "backcharges" and wrongfully refuses to pay to plaintiff.

WHEREFORE, Use plaintiff prays for relief as follows:

1. For leave to amend its Complaint to include additional monies due and payable to Use plaintiff under its subcontract, but retained by defendant Ets-Hokin Corporation as and for backcharges to cover cost of prestressing spiral cases at the Glen Canyon Dam Powerplant, or other alleged costs not properly chargeable to plaintiff.

2. For judgment against defendant Ets-Hokin Corporation in the sum of \$33,167.41, or such other greater sum found to be due at time of judgment as and for wrongful backcharges by said defendant.

3. For judgment against defendant The Travelers Indemnity Company in the sum of \$33,167.41 or such other greater sum as found to be due at time of judgment as and for wrongful backcharges by defendant Ets-Hokin Corporation.

4. For interest on all of said sums determined to have been wrongfully retained by said defendant Ets-Hokin Corporation from the date such sums became due and payable to Use plaintiff until payment thereof.

5. For such other and further relief as the Court may deem proper.

RYLEY, CARLOCK & RALSTON

By /s/ FRANK C. BROPHY, JR.

*Attorneys for Plaintiff
Chicago Bridge & Iron
Company*

519 Title & Trust Building
Phoenix, Arizona 85003



In the
UNITED STATES COURT OF APPEALS
For the NINTH CIRCUIT

UNITED STATES OF AMERICA, For
the Use and Benefit of CHICAGO
BRIDGE & IRON COMPANY, an
Illinois corporation,

Appellant.

vs.

ETS-HOKIN CORPORATION, a
California corporation, and
THE TRAVELERS INDEMNITY COMPANY,
a Connecticut corporation,

Appellees.

No. 21816

FILED

DEC 17 1967

NOV 10 1967

APPELLEES' BRIEF

FELDMAN, WALDMAN & KLINE
2700 Russ Building
San Francisco
California 94104

Attorneys for Appellees

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2700 Russ Building
San Francisco
California 94104

Attorneys for Appellees

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STATEMENT OF JURISDICTION

The United States District Court for the Northern District of California had jurisdiction to hear Appellees' Petition to Confirm Arbitration Award under Section 9 of the United States Arbitration Act, 9 U.S. Code §9, and to hear Appellant's Application for Order of the Court to Set Aside Arbitration Award under Section 10 and 11 of the United States Arbitration Act, 9 U.S. Code §§10 and 11. This Court has jurisdiction to determine this appeal under 28 U.S. Code §1291. The judgment of the United States District Court for the Northern District of California, from which this appeal has been taken, was entered on January 16, 1967. Appellant filed its notice of appeal on February 15, 1967,^{*/} the thirtieth day after entry of judgment. Therefore, this appeal is timely.

STATEMENT OF THE CASE

Statement of Facts

Appellee Ets-Hokin Corporation (hereinafter "Ets-Hokin") is the prime contractor and the United States Bureau of Reclamation, Department of the Interior, is the owner under United States Government Contract No. 14-06-D-4429, dated

^{*/}On page 2 of its Opening Brief, Appellant states that it filed its notice of appeal on March 14, 1967, which was the fifty-seventh day after entry of judgment. If this were true, Appellees would contend that this appeal was not timely, as they have in appeal No. 21033, with which this appeal has been consolidated for hearing.

June 25, 1962, which calls for Ets-Hokin to perform certain work in the completion of the powerhouse and switchyard at the Glen Canyon Dam, Page, Arizona. Appellee The Travelers Indemnity Company (hereinafter "Travelers") is Ets-Hokin's surety on the prime contract and has furnished the performance and payment bonds required by section 1 of the Miller Act, 40 U.S. Code §270a. Appellant Chicago Bridge & Iron Company (hereinafter "CB&I") entered into a written subcontract with Ets-Hokin on August 22, 1962, which called for CB&I to perform a portion of the work required under the prime contract. (Tr. pp. 119-124.)

During the performance of the prime contract and the subcontract a dispute arose between Ets-Hokin and CB&I as to whether CB&I was required to perform certain work, namely, the prestressing of the turbine spiral cases, under the subcontract. CB&I denied that it was required to do this work and refused to do the same. Ets-Hokin performed the work and to cover the cost of doing the work withheld from CB&I's progress payments the sum of \$37,077.56.

On or about July 8, 1964, CB&I filed in the United States District Court for the District of Arizona, Prescott Division, action number Civ. 917 Pct. In this action, under section 2 of the Miller Act, 40 U.S. Code §270b, CB&I sought judgment from Ets-Hokin and Travelers on said Miller Act payment bond in the amount of said sum of \$37,077.56. On August 14, 1964, Ets-Hokin demanded arbitration in accordance

1 with Article 23 of the General Conditions of the subcontract.
2 (See Misc. Exhibits to Transcript.) On or about August 20,
3 1964, Ets-Hokin and Travelers filed a Motion for Stay of Action
4 Pending Arbitration under Section 3 of the United States
5 Arbitration Act, 9 U.S. Code §3. On or about August 27, 1964,
6 CB&I filed its Response to that Motion for Stay Pending
7 Arbitration.

8 On August 26, 1964, oral argument on the Motion for
9 Stay Pending Arbitration was held before Judge Muecke of the
10 District Court. At the oral argument counsel for Appellees
11 stipulated that Travelers would be bound by any award entered
12 by the arbitrators. Judge Muecke granted the motion from the
13 bench at the conclusion of the oral argument and entered the
14 following minute order:

15 "It is ordered that Defts' Motion for
16 Stay of action pending arbitration is granted,
17 only as to specific items raised in the motion,
18 subject to either party coming back to the court
for relief by reason of any delay in such arbit-
ration."

19 CB&I did not appeal from the stay order.

20 In accordance with the court's order CB&I selected
21 as its arbitrator Mr. L. A. Elsener and Appellees selected
22 Mr. J. P. Murphy. Messrs. Elsener and Murphy selected as the
23 third arbitrator Mr. T. J. Corwin, Jr.

24 On March 9, 1965, the arbitrators requested counsel
25 to submit to the arbitration board a brief memorandum of their
26 clients' positions. Such memoranda of position (Tr. pp. 66-76)



1 were filed with the arbitrators by Appellees and Appellant on
2 March 22, and March 23, 1965, respectively. These memoranda
3 were referred to by the court below in paragraph (f) on page 5
4 of its Order Confirming Award of Arbitrators. (Tr. p. 134.)

5 Late in April, 1965, the arbitrators had their first
6 formal meeting. At that time, Mr. Corwin, the neutral arbitra-
7 tor, presented a set of 21 questions which he desired to have
8 answered by the parties in order to give the board a complete
9 background of the technical dispute between the parties.
10 Answers to these questions were delivered to the board by the
11 parties at the opening of the arbitration hearing on July 6,
12 1965. The questions of Mr. Corwin and Appellees' answers there-
13 to were submitted to the court below by CB&I as exhibits to its
14 Objections to Confirmation of Award. (Tr. p. 18.) The District
15 Court referred to the answers in paragraph (e) on page 5 of its
16 Order Confirming Award of Arbitrators (Tr. p. 134.)

17 The arbitration hearing was held in San Francisco,
18 on July 6 and 7, 1965, At the outset of the hearing, after
19 preliminary statements by counsel for both parties, counsel
20 for CB&I called as its witness Mr. J. Graham Daniels, District
21 Sales Manager of CB&I. Mr. Daniels testified that CB&I and
22 Ets-Hokin had entered into the subcontract which was before
23 the board, that CB&I had performed all of its obligations under
24 the subcontract, and that there remained due and owing on the
25 -----
26 -----



subcontract the sum of \$37,077.56. (RTAP^{*}/pp. 7-12.) At this point, counsel for CB&I stated he was resting his case and called upon the board to make an award in CB&I's favor based only upon the foregoing testimony of Mr. Daniels and application of the parol evidence rule. (RTAP pp. 12-16.) Counsel for Appellees argued that the very issue before the arbitrators was the meaning of the subcontract, that the board was not in a position to rule that the contract was unambiguous on its face, and that therefore the board should not preclude the introduction of extrinsic evidence to explain the meaning of the subcontract. (RTAP pp. 16-17, 23-24.) The board decided to take CB&I's counsel's motion for an immediate award under advisement and determined to proceed with further testimony. (RTAP p. 27.) Most of the remaining testimony taken over the next day and one-half of hearing concerned itself with the negotiations leading up to the signing of the subcontract and the interpretation of the parties of the various terms of preliminary offers and of the subcontract itself. A relatively small portion of the testimony had to do with the calculation of the backcharges by Ets-Hokin against CB&I which were the subject of the dispute.

At the hearing, CB&I submitted to the board a Brief of Facts, Law, and Argument. (Tr. pp. 77-101.) Counsel for Appellees asked for permission to reply to CB&I's brief, which

^{*}/ Reference is made to Reporter's Transcript of Arbitration Proceedings, Volumes 1 and 2, which are Miscellaneous Exhibits to the Transcript.

1 permission was granted. (RTAP pp. 179-180, and 304-305.)
2 These briefs were referred to by the court below in paragraph
3 (g) on page 5 of its Order Confirming Award of Arbitrators.
4 (Tr. p. 134.)

5 On August 26, 1965 Mr. Charles Ziemer, of CB&I's
6 legal department, wrote to Mr. Elsener, the arbitrator appointed
7 by CB&I, enclosing certain tabulations of alleged discrepancies
8 in the calculation of the backcharges by Ets-Hokin. (Tr.
9 pp. 38-47.) This letter constitutes the basis of CB&I's conten-
0 tion that the court below should have modified the award.

1 On August 30, 1964, the board issued a written
2 memorandum signed by two of its members, Messrs. Corwin and
3 Murphy. (Tr. pp. 125-129.) The third arbitrator, Mr. Elsener,
4 filed a written dissent as to "some of the findings stated in
5 the award". (Tr. p. 65.) The court below referred to the
6 majority memorandum and the dissent in paragraphs (h) and (i),
7 respectively, on page 5 of its Order Confirming Award of
8 Arbitrators. (Tr. p. 134.) The board's award in effect held
9 that Ets-Hokin was entitled to backcharge CB&I in the amount
0 of \$16,850.45 and that it must pay to CB&I the balance of
1 moneys withheld, namely, \$20,227.11.

2 On November 5, 1965, counsel for Appellees advised
3 counsel for CB&I in writing that Ets-Hokin was thereby formally
4 tendering to CB&I the amount awarded by the arbitration board,
5 namely, \$20,227.11. Counsel for CB&I thereafter responded by
6 telephone that CB&I intended to challenge the award in subse-

quent legal proceedings. The formal tender was therefore rejected.

On or about November 24, 1965, CB&I filed its Motion to Vacate Stay Order and Alternate Motion to Vacate the Arbitration Award in the United States District Court for the District of Arizona. From the denial of that Motion and Alternate Motion CB&I has taken its appeal in No. 21033, which has been consolidated for hearing with the within appeal.

On or about November 29, 1965, CB&I filed in the United States District Court, Northern District of California, Matter No. 44430, entitled Application for Order of the Court to Set Aside Arbitration Award. (Tr. p. 25.) On December 20, 1965, Ets-Hokin and Travelers filed their Reply and Memorandum in Opposition to Application. (Tr. p. 51.) On December 20, 1965, Ets-Hokin and Travelers also filed in the United States District Court, Northern District of California, Matter No. 44552, entitled Petition to Confirm Arbitration Award. (Tr. p. 116.) On or about February 4, 1966, CB&I filed its Objections to Confirmation of Award. (Tr. p. 10.) On March 23, 1966, Ets-Hokin and Travelers filed their Memorandum in Support of Petition to Confirm Arbitration Award. (Tr. p. 1.)

On March 1, 1966, the court below, pursuant to stipulation of the parties, consolidated matters Nos. 44430 and 44552 for all further proceedings before the court. Oral argument on both matters was held before Judge Zirpoli on March 30, 1966. On December 30, 1966, Judge Zirpoli issued

1 his Order Confirming Award of Arbitrators (Tr. p. 130), which
2 also denied CB&I's Application for Order of the Court to Set
3 Aside Award. The court concluded in its Order with the follow-
4 ing sentence:

5 "This opinion shall constitute the
6 findings of fact and conclusions of law
7 of the Court, and based thereon defendant
is directed to submit an appropriate
judgment to the Court." (Tr. p. 139.)

8 Judgment on the court's Order was signed by Judge Zirpoli on
9 January 11, 1967 (Tr. p. 49.), and was entered of record on
10 January 16, 1967. (Tr. p. 50.) On February 15, 1967, CB&I
11 filed its Notice of Appeal from the Judgment of the court below
12 (Tr. p. 140.), and filed its Appeal Bond in the amount of
13 \$250.00 (Tr. p. 142.)

14 Questions Presented

15 1. Did the order of the United States District Court
16 for the District of Arizona, which stayed CB&I's Miller Act
17 lawsuit pending arbitration, limit the authority of the arbitra-
18 tors to decide issues presented to them?

19 2. What is the scope of review by a court of an
20 arbitration award?

21 3. Was the court below correct in finding that the
22 parties expanded the issues presented to the arbitrators by
23 their later acts?

24 4. Was the court below correct in finding that the
25 arbitrators had ruled that CB&I undertook contractually to
26 perform the prestressing work?



1 5. Was the court below correct in finding that the
2 arbitrators heard extrinsic evidence only for the purpose of
3 interpreting the subcontract?

4 6. Was the court below correct in finding that there
5 was no basis for modification of the award?

6 SUMMARY OF ARGUMENT

7 1. The Court Below Correctly Decided That The Order
8 Of The United States District Court For The District Of Arizona,
9 Staying The Litigation Pending Arbitration, Did Not Limit The
10 Power Of The Arbitrators To Consider All Issues Put To Them By
11 The Parties.

12 2. The Scope Of Review Of An Arbitration Award Is
13 Extremely Limited. A Court May Not Substitute Its Judgment For
14 That Of The Arbitrators. An Award May Not Be Set Aside By A
15 Court For Error Either In Law Or Fact, Nor For Mere Ambiguity
16 In The Opinion Accompanying The Award.

17 3. The Court Below Properly Found That By Their Acts
18 The Parties Had Broadened The Issues Submitted To The Arbitrators
19 To Include The Issue Of The Intent And Understanding Of The
20 Parties As To Who Would Perform The Work Of Prestressing The
21 Spiral Cases.

22 4. The District Court Was Correct In Finding That The
23 Arbitrators Had Ruled That CB&I Was Contractually Bound To Per-
24 form The Prestressing Work, Even Though This Obligation Was Not
25 An Express Written Covenant Of The Contract.

26 -----



1 5. The Court Below Properly Held That The Board
2 Resorted To Extrinsic Evidence Only To Clear Up An Ambiguity In
3 The Subcontract, Namely, To Determine Whether The Installation
4 Of The Spiral Cases Was Intended And Understood By The Parties
5 To Include The Prestressing Of The Spiral Cases.

6 6. The Court Below Correctly Refused To Modify The
7 Award.

8 ARGUMENT

9 1. The Court Below Correctly Decided That The Order
0 Of The United States District Court For The District Of Arizona,
1 Staying The Litigation Pending Arbitration, Did Not Limit The
2 Power Of The Arbitrators To Consider All Issues Put To Them By
3 The Parties.

4 CB&I contends that the order of the Arizona District
5 Court, which granted Ets-Hokin's Motion for Stay of Action Pend-
6 ing Arbitration "only as to specific items raised in the motion"
7 limits the issues which could be placed before the arbitrators
8 by the parties. Judge Zirpoli answered this contention properly
9 and completely in his Order Confirming Award of Arbitrators. (Tr.
0 p. 135.) He said:

1 "Before considering the merit of plaintiff's
2 [CB&I's] position, it should be noted that the
3 arbitrators' authority was not limited by the
4 order of the Arizona District Court. The remedy
5 sought by the defendant [Ets-Hokin] in the Arizona
6 District Court was merely the staying of the



1 Miller Act lawsuit under Section 3 of Title
2 9 U.S.C.* The Court's order did not direct
3 the parties to arbitrate. It merely stayed
4 the lawsuit pending arbitration in accordance
5 with the agreement of the parties. Thus, the
6 arbitrators derived their authority not from
7 the order of the Court, but from the arbitra-
8 tion agreement, Article 23 of the General
9 Conditions of the Subcontract, as specified
10 by the demand for arbitration and the later
11 statements and briefs of the parties defining
12 the issues for arbitration. American Almond
13 Products Co. v. Consolidated Pecan Sales Co.
14 [144 F. 2d 448, 450 (2d Cir. 1944)]."

15 Judge Zirpoli, in his decision, correctly differentia-
16 ted section 3 from section 4**/ of the United States Arbitration
17 Act. Section 3 provides for a stay of litigation before the
18 court pending arbitration under an agreement between the parties.
19 Section 4 provides for an order that the parties arbitrate
20 certain disputes. CB&I argues on pages 9-10 of its Opening
21 Brief that sections 3 and 4 should be read together, thus con-
22 verting a stay order under section 3 to a mandate to arbitrate.
23 CB&I cited no authority in support of this argument. Nor does
24 logical analysis justify the rewriting of the express statutory
25 language. This argument should be rejected.

26 It is absolutely clear from the record that Ets-Hokin
sought and obtained an order staying the Miller Act action under
section 3 pending an arbitration in accordance with Article 23

* / Set out in full in Appellant's Opening Brief, Appendix B.

** / The full text of section 4 of the United States Arbitration
Act is set out in the Appendix to this Brief.



1 of the subcontract between the parties, which provided for
2 arbitration of all disputes arising out of the subcontract.

3 After the stay order, the parties proceeded with the
4 arbitration, wrote memoranda, argued their case to the arbit-
5 rators, put on witnesses, and introduced documents in evidence.
6 CB&I made no objection to the board that it considered the
7 arbitration to be improperly or illegally constituted or that it
8 was proceeding with the arbitration only under protest. CB&I
9 made no objection that the arbitrators were considering questions
10 beyond the scope of the stay order. Only after it received what
11 it considered to be an unfavorable award did it return to the
12 court to complain that the arbitrators exceeded their powers.

13 Appellees submit that even though CB&I agreed to
14 arbitrate rather than litigate its disputes, CB&I has demonstra-
15 ted that it would be willing to accept the results of the arbit-
16 ration only if it considered the award to be in its favor. When
17 it determined that the award was not in its favor, CB&I sought
18 to litigate the dispute as if there were no arbitration clause.
19 Arbitration is meant to provide a quick and final remedy to
20 disputes, not to be a mere prelude to litigation. In the
21 American Almond case, supra, on facts much less favorable to
22 the party seeking to uphold the award, the court refused to let
23 the other party proceed through the arbitration to an award,
24 allowing the arbitrators to consider a question without protest,
25 and then protest to the court that the arbitrators were exceed-
26 ing their powers in considering that question. American Almond



1 Products Co. v. Consolidated Pecan Sales Co., 144 F. 2d 448,
2 450 (2d Cir. 1944). CB&I should not be allowed two bites at
3 the apple.

4 2. The Scope Of Review Of An Arbitration Award Is
5 Extremely Limited. A Court May Not Substitute Its Judgment For
6 That Of The Arbitrators. An Award May Not Be Set Aside By A
7 Court For Error Either In Law Or Fact, Nor For Mere Ambiguity
8 In The Opinion Accompanying The Award.*/

9 All objections made by CB&I in its Opening Brief, other
10 than that answered in paragraph 1 of the Argument above, are
11 objections to the award of the arbitrators. This paragraph 2
12 sets out the established principles which guide a court in its
13 review of an arbitration award. Succeding paragraphs will
14 answer specific objections made by CB&I to the award.

15 The leading case in this circuit on the scope of
16 review of an arbitration award is San Martine Compania De
17 Navegacion, S.A. v. Saguenay Terminals Ltd., 293 F. 2d 796 (9th
18 Cir. 1961). In that case, after an award by the arbitrators
19 awarding certain sums of money to San Martine as damages, the
20 District Court for the District of Hawaii, in a proceeding on a
21 petition for confirmation of the award, modified the award
22 deleting therefrom the items of damages. The District Court
23

24 */CB&I has recognized the extremely limited scope of review of
25 arbitration awards. See its Opening Brief in No. 21033, with
26 which this appeal has been consolidated for hearing, pages
12-14, and its Reply Brief in No. 21033 p. 8.



1 based its order on the grounds that the arbitrators "exceeded
2 their jurisdiction and that the award of damages in the above
3 amount was beyond the scope of the arbitrators' authority".
4 This Court reversed.

5 In its decision, this Court made the following state-
6 ments, which state rules of law binding under the doctrine of
7 stare decisis. They are also persuasive in their logic:

8 "It may well be that the arbitrators'
9 views of the facts and of the law relating
10 to the matters on account of which they
11 awarded damages are open to serious question.
12 . . . But an award such as this, which is
13 one within the terms of the submission, will
14 not be set aside by a court for error either
15 in law or fact. This rule and the reasons
16 for it were set forth in *Burchell v. Marsh*,
17 17 How. 344, 58 U.S. 344, 349, 15 L. Ed. 96:
18 'Arbitrators are judges chosen by the parties
19 to decide the matters submitted to them,
20 finally and without appeal. As a mode of
settling disputes, it should receive every
encouragement from courts of equity. If the
award is within the submission and contains
the honest decision of the arbitrators, after
a full and fair hearing of the parties, a
court of equity will not set it aside for
error, either in law or fact. A contrary
course would be a substitution of the judg-
ment of the chancellor in place of the judges
chosen by the parties, and would make an
award the commencement, not the end, of
litigation.'

21 "As stated in *Amicizia Societa Navegazione*
22 *v. Chilean Nitrate and Iodine S. Corp.*, 2 Cir.,
23 274 F. 2d 805, 808: 'The statutory provisions,
24 9 U.S.C.A. §§10, 11, in expressly stating
25 certain grounds for either vacating an award
or modifying or correcting it, do not authorize
its setting aside on the grounds of erroneous
finding of fact or of misinterpretation of law.'" (293 F. 2d, at 800.)

26 Thus, a court, in reviewing an award of an arbitration



1 board, may not substitute its judgment for that of the arbitrators
2 It is limited by sections 10 and 11 of the United States
3 Arbitration Act, 9 U.S. Code §§ 10, 11,* to the grounds there
4 specified for vacation or modification of the award. Mere error
5 of law or fact are not among those stated grounds.

6 Nor is ambiguity in the award grounds for vacation or
7 modification. As the United States Supreme Court said in United
8 Steel Workers of America v. Enterprise Wheel & Car Corp., 363
9 U.S. 593, 598 (1960):

10 ".... A mere ambiguity in the opinion accompany-
11 ing an award, which permits the inference that
12 the arbitrator may have exceeded his authority,
13 is not a reason for refusing to enforce the
14 award. Arbitrators have no obligation to the
15 court to give their reasons for an award. To
16 require opinions free of ambiguity may lead
arbitrators to play it safe by writing no
supporting opinions. This would be undesirable
for a well-reasoned opinion tends to engender
confidence in the integrity of the process and
aids in clarifying the underlying agreement...."

17 See also Note, 63 Harv. L. Rev. 681, "Judicial Review of
18 Arbitration Awards on the Merits" (1950).

19 Having stated the general principles which we respect-
20 fully suggest must guide this Court in its review of the
21 decision of the court below upholding the award of the arbitra-
22 tors, we next proceed to consider the specific objections to the
23 District Court's ruling, and hence to the award of the arbitra-
24 tors, raised by CB&I in its Opening Brief.

25
26 */ Set out in full in Appellant's Opening Brief, Appendix B.

1 3. The Court Below Properly Found That By Their Acts
2 The Parties Had Broadened The Issues Submitted To The Arbitra-
3 tors To Include The Issue Of The Intent And Understanding Of
4 The Parties As To Who Would Perform The Work Of Prestressing
5 The Spiral Cases.

6 The burden was upon CB&I to demonstrate that the award
7 was beyond the powers of the arbitrators and should therefore be
8 set aside. American Almond Products Co. v. Consolidated Pecan
9 Sales Co., 144 F. 2d 448, 450 (2d Cir. 1944). The court below
10 applied this rule (Tr. p. 131, lines 6-11.) and held that CB&I
11 had not sustained its burden. (Tr. p. 138, lines 16-21.)

12 The District Court found that "the Board was not
13 limited in its powers to the subcontract and the first demand
14 of defendant [Ets-Hokin] for arbitration made on August 14,
15 1964." (Tr. p. 135, lines 16-19.) The court further found that
16 the demand for arbitration was broadened by the parties in their
17 preliminary statements of issues submitted to the arbitrators
18 prior to the hearing, the statement of CB&I's counsel at the
19 hearing, and the answers of the parties to questions propounded
20 by the neutral arbitrator, Mr. Corwin.

21 CB&I argues, on pages 11-19 of its Opening Brief, that
22 at no time did it agree to expand the issues before the arbit-
23 rators to include the intent and understanding of the parties.
24 CB&I goes into a lengthy explanation of what it meant in each
25 instance pointed to by the District Court as evidence of an
26 expansion of the issues. However, the subjective intent of



1 CB&I or its counsel is irrelevant. What is relevant is what
2 the parties said and did and what the arbitrators could reason-
3 ably believe were the issues submitted to them for decision.
4 On the record, Appellees submit that the District Court properly
5 concluded that the award was within the scope of the issues
6 submitted, as the issues had been supplemented and broadened by
7 the acts and statements of the parties. (Tr. p. 138, lines
8 1-10.)

9 4. The District Court Was Correct In Finding That The
10 Arbitrators Had Ruled That CB&I Was Contractually Bound To Per-
11 form The Prestressing Work, Even Though This Obligation Was Not
12 An Express Written Covenant Of The Contract.

13 CB&I repeatedly argues that the arbitrators found that
14 CB&I did not agree in the subcontract to perform the prestress-
15 ing work, but that nevertheless the arbitrators determined to
16 impose a moral obligation on CB&I to do or pay for the prestress
17 ing work. Much of its argument under Specification of Error No.
18 2 and all of its argument in paragraph A under Specification of
19 Error No. 3 of its brief is directed to this point. In examin-
20 ing CB&I's argument it might appear that the question of whether
21 CB&I agreed to furnish a "standby operator" is something
22 different from the question of whether CB&I agreed to do the
23 prestressing. It is not. Ets-Hokin's backcharges consisted of
24 the wages paid to the man who was charged with watching the
25 pressure gauges during the prestressing period, that is, the
26 "standby operator". (See RTAP pp. 192, 232-233, 261-262,

1 319-320.)

2 Appellees submitted to the court below, and the court
3 found (Tr. p. 136, line 24, page 137, line 5.), that a reason-
4 able interpretation of the paragraphs 8, 11, and 12 of the
5 majority opinion^{*/} is that while there was no express covenant
6 in the subcontract for CB&I to perform the prestressing work, it
7 was understood and intended by the parties that the task of
8 installation of the spiral cases included the prestressing work.
9 This was a contractual, not merely a moral, obligation.

10 The District Court further pointed out that:

11 "This understanding of findings 8, 11
12 and 12 is confirmed in the penultimate para-
13 graph of arbitrator Elsener's dissent, wherein
14 he states: '... Either Chicago Bridge agreed
15 to do the prestressing work or it did not.
16 The majority of this Board says it did.
17 [Emphasis by District Court.]' " (Tr. p. 137,
18 lines 5-10.)

19 Still later in its opinion the District Court found that,

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Findings 8, 11, and 12 of the majority opinion of the Board provide:

"8. That the oral offering of furnishing a stand-by operator by a responsible representative of Chicago Bridge and Iron Company to secure a contract should be as binding as the written word, as no evidence was presented of a written acceptance or refusal of this offer.

"11. That Chicago Bridge and Iron Company should have performed the prestressing of the spiral case and the Ets-Hokin Corporation should have performed the cooling of the concrete surrounding the spiral case.

"12. That the Chicago Bridge and Iron Company's claim that if responsible, they should not be charged overtime rates, this must be denied as Exhibit 83, pp. C-9, covers work which Chicago Bridge and Iron Company agrees to perform, etc. Evidence indicates they did not agree to perform the prestressing work."



1 "[E]ven if it be conceded that a comparison
2 of paragraph 8, 11 and 12 of the majority
3 opinion accompanying the award leads one to
4 conclude that the award was ambiguous, this is
5 not a ground for the Court to set aside the
6 award. [Citing United Steel Workers of
America v. Enterprise Wheel & Car Corp., *supra*,
7 paragraph 2 of this Argument.]" (Tr. p. 138,
8 lines 22-27.)

9 Finally, Appellees submit that if the District Court's
10 and CB&I's differing interpretations of the meaning of the
11 majority opinion accompanying the award are both plausible, it
12 is the rule that the interpretation should be given the award
13 which upholds its validity. Griffith Co. v. San Diego College
14 for Women, 45 Cal. 2d, 501, 516 (1955), Nickals v. Ohio Farmers
15 Ins. Co., 237 F. Supp. 904, 906 (N.D. Cal. 1965). In this case,
16 the District Court's interpretation of the award should be
17 upheld.

18 5. The Court Below Properly Held That The Board
19 Resorted To Extrinsic Evidence Only To Clear Up An Ambiguity In
20 The Subcontract, Namely, To Determine Whether The Installation
21 Of The Spiral Cases Was Intended And Understood By The Parties
22 To Include The Prestressing Of The Spiral Cases.

23 CB&I says again and again that the arbitrators by
24 hearing extrinsic evidence violated the integration parol
25 evidence rule and in effect made a contract for the parties. As
26 we showed in paragraph 4 of this Argument, the District Court
found that the arbitrators were enforcing what they found to be
an existing contractual (legal) obligation.

The court below further found (Tr. p. 135, lines



1 22-30, p. 138, lines 1-9) that on the basis of the entire reco
2 as summarized on pages 4 and 5 of its Order Confirming Award o
3 Arbitrators (Tr. pp. 133-134), the arbitrators resorted to ex-
4 trinsic evidence only to assist them in interpreting the
5 ambiguity in the subcontract as to whether or not the work of
6 installing the spiral cases included the prestressing work.
7 Appellees submit that the record fully supports the court's
8 finding on the use of extrinsic evidence.

9 Even if the arbitrators "violated the parol evidence
10 rule", as CB&I argues,* / that is not a ground for vacation of
11 the arbitration award. This is but another application of the
12 rule argued at length in paragraph 2 of this Argument that an
13 award is not to be set aside for mere errors of law. Unless
14 the parties agree that the arbitrators are to be bound to appl
15 technical rules of law, they are free to decide a dispute in
16 accordance with their notion of justice. See 5 Am Jur 2d,
17 Arbitration and Award §140, particularly the authorities cited
18 at notes 5 and 6. See also Annotation, 112 ALR 878; and Sapp
19 v. Barenfeld, 34 Cal. 2d 515, 520 (1949). In the Sapp case th
20 court said, at page 523:

21 "Even though a party expressly asserts a
22 lawful claim in the submission or raises it
23 by the presentation of evidence to the arbit-
24 rators, the law does not guarantee that the
claim will be allowed. Arbitrators, unless

25 *

26 CB&I recognized that the arbitrators were not bound to appl
the parol evidence rule and so stated in argument to the
arbitrators at the hearing. (RTAP, p. 15, lines 3-7.)

1 specifically required to act in conformity
2 with rules of law, may base their decision
3 upon broad principles of justice and equity,
4 and in doing so may expressly or impliedly
5 reject a claim that a party might success-
6 fully have asserted in a judicial action.
7 . . . Even if the omission to find as to
8 those items was due to a mistake on the
9 part of the arbitrators, nevertheless the
10 omission was in effect a disallowance of
11 those items, which became final and con-
12 clusive when the award was made and proper
13 notice thereof given to the interested
14 parties."

15 6. The Court Below Correctly Refused To Modify The
16 Award.

17 The District Court's power to modify the award of the
18 arbitrators is derived from and limited to the specific instances
19 set out in subsections (a), (b) and (c) of Section 11 of the
20 United States Arbitration Act, 9 U.S. Code §11.* / As Appellees
21 argued to the court below (Tr. p. 6), the only provision of
22 Section 11 on which CB&I could rely for the modification of the
23 award was the first clause of subsection (a) of Section 11,
24 which provides that the court may modify or correct the award
25 "where there was an evident material miscalculation of figures."
26 The power of the District Court to modify the award due to an
evident material miscalculation of figures must be limited to a
miscalculation on the face of the award itself. Otherwise, the
court would in effect be substituting its judgment for that of
the arbitrators in the guise of modifying or correcting the

* / Set out in full in Appendix B to Appellant's Opening Brief.



award. James Richardson & Sons, Ltd. v. W.E. Hedger Transportation Corp., 98 F. 2d 55, 57 (2d Cir. 1938), San Martine Compania De Navegacion, S.A. v. Saquenay Terminals, Ltd., supra. It is certainly not evident from the face of the award that there has been a material miscalculation of figures by the arbitrators. Therefore, the court below was correct in rejecting Appellant's request for modification.

If this Court should determine to go beyond the face of the award in determining whether there has been a miscalculation, Appellees point out, as they did to the court below (Tr. pp. 7 and 8) that there is no evidence that any verified information requiring a modification of the award was ever submitted to the arbitrators. Instead, it appears from the record that Mr. Ziemer, an employee of CB&I, transmitted a tabulation of alleged discrepancies to CB&I's arbitrator on August 26, 1965. (Tr. pp. 38-47.) In his covering letter Mr. Ziemer stated "You may wish to submit a copy of the attached to Corwin to show him that discrepancies do exist and should be explained and an amount arrived at before any finding in terms of dollars is made by the board." For all that is shown in the record, what Mr. Elsener did or did not do is unknown. He did not mention this point in his separate opinion dated August 30, 1965.

The court below was correct in refusing to speculate as to what "corrections" might have been made by the board had the evidence been properly submitted to the board.

This Court should affirm the District Court's refusal

1 to modify the award.

2 CONCLUSION

3 1. The power of the arbitrators to decide the
4 questions put to them by the parties was not limited by the
5 order of the Arizona District Court staying CB&I's Miller Act
6 action pending arbitration. The arbitrators derived their
7 authority not from the order of the Arizona District Court but
8 from the agreement of the parties and their later acts defining
9 the issues for arbitration.

0 2. An award may not be set aside by a court except on
1 the grounds stated in Section 10 of the United States Arbitration
2 Act. These grounds do not include error of law or fact or
3 ambiguity in the opinion accompanying the award.

4 3. The issues submitted to the arbitrators included
5 the intent and understanding of the parties as to who would
6 perform the prestressing, that is, who would furnish the standby
7 operator.

8 4. The arbitrators found that CB&I contractually
9 bound itself to perform the prestressing.

0 5. In hearing extrinsic evidence to explain the
1 ambiguity in the subcontract, the arbitrators did not violate
2 the parol evidence rule. Even if they did violate the parol
3 evidence rule, such violation at worst constituted an error of
4 law, for which an award may not be set aside.

5 6. Nothing on the face of the award evidences a
6 material miscalculation of the amount of the award. Furthermore,

1 nothing in the record demonstrates that the board did not
2 properly calculate the award on the basis of evidence submitted
3 to them.

4 7. CB&I has not sustained its burden to demonstrate
5 that the award should be vacated or modified. The judgment of
6 the court below affirming the award of the arbitrators and
7 refusing to vacate or modify the award should be affirmed.

8 Respectfully submitted,

9 FELDMAN, WALDMAN & KLINE

10 Attorneys for Appellees

11 By Laurence N. Walker
12 Laurence N. Walker

13
14 I certify that, in connection with the preparation of
15 this brief, I have examined Rules 18, 19, and 39 of the United
16 States Court of Appeals for the Ninth Circuit, and that, in my
17 opinion, the foregoing brief is in full compliance with those
18 rules.

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20 Laurence N. Walker
21 Laurence N. Walker
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APPENDIX

Sec. 4, United States Arbitration Act, 9 U.S. Code §4.

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is



1 raised, the party alleged to be in default may, except in cases
2 of admiralty, on or before the return day of the notice of
3 application, demand a jury trial of such issue, and upon such
4 demand the court shall make an order referring the issue or
5 issues to a jury in the manner provided by the Federal Rules
6 of Civil Procedure, or may specially call a jury for that pur-
7 pose. If the jury find that no agreement in writing for arbit-
8 ration was made or that there is no default in proceeding
9 thereunder, the proceeding shall be dismissed. If the jury
10 find that an agreement for arbitration was made in writing and
11 that there is a default in proceeding thereunder, the court
12 shall make an order summarily directing the parties to proceed
13 with the arbitration in accordance with the terms thereof.



No. 21816

In the
United States Court of Appeals
For the Ninth Circuit

UNITED STATES OF AMERICA, For the Use
and Benefit of CHICAGO BRIDGE & IRON
COMPANY, an Illinois corporation,

Appellant,

vs.

ETS-HOKIN CORPORATION, a California cor-
poration, and THE TRAVELERS INDEMNITY
COMPANY, a Connecticut corporation,

Appellees.

On Appeal from the United States District Court
for the District of Arizona

Appellant's Reply Brief

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WM. B. LUCK, CLERK

RYLEY, CARLOCK & RALSTON
FRANK C. BROPHY, JR.

Title and Trust Building
Phoenix, Arizona 85003

Attorneys for Appellant

JAN 5 1968

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No. 21,816

In the
United States Court of Appeals
For the Ninth Circuit

UNITED STATES OF AMERICA, For the Use
and Benefit of CHICAGO BRIDGE & IRON
COMPANY, an Illinois corporation,

Appellant,

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ETS-HOKIN CORPORATION, a California cor-
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COMPANY, a Connecticut corporation,

Appellees.

On Appeal from the United States District Court
for the District of Arizona

Appellant's Reply Brief

I.

ARBITRATORS EXCEEDED THEIR POWERS UNDER 9 U.S.C. SECTION 10(d) WHERE THEY MISUSE PAROL EVIDENCE TO IMPOSE DUTY UPON APPELLANT TO PERFORM WORK NOT WITHIN SCOPE OF APPELLANT'S SUBCONTRACTUAL OBLIGATIONS.

A. Reasonableness of District Court's Interpretation of Arbitration Award.

An examination of the Opening and Answering Briefs on file herein leads Appellant to the conclusion that the principal issue for the Court in this Appeal is:

Was the District Court below in error when it concluded that the Arbitration Award should be affirmed, because it could be construed to have held that the work of prestressing was an implicit part of the work described in paragraph 1 (b) or any other part of the written subcontract dated August 22, 1962 taken severally or together? Appellees have stated in their Brief (p. 18):

“... the Court (District Court) found (TR. p. 136, line 24, page 137, line 5), that a reasonable interpretation of the paragraphs 8, 11 and 12 of the majority opinion is that while there is no express covenant in the subcontract for CB&I to perform the prestressing work, it was understood and intended by the parties that the task of installation of the spiral cases included the prestressing work.”

Appellant submits that any such finding by the Lower Court is not a reasonable interpretation of paragraph 8, regardless of whether it is read in conjunction with paragraph's 11 and 12 of the Arbitration Award, or by itself.

An oral offer to furnish a standby operator which was neither accepted nor refused in writing and as to which there was not one shred of testimony in the arbitration record that such offer was ever orally accepted by the Appellee Ets-Hokin,* was not adjudged by the arbitrators to be an obligation of the written subcontract. The arbitrators are not saying that because Appellant agreed to install the

*Appellees' have argued that it is incredible beyond belief to assert that Ets-Hokin rejected the oral offer (Transcript of Arbitration Hearings, Vol. II, page 319, line 1-5), yet the argument misses the point. Unless the offer could be shown to be a part of the written subcontract either expressly or by necessary implication, it was beyond the scope of the dispute submitted to arbitration, notwithstanding the Lower Court's apparent conclusion that the dispute was expanded beyond the issues raised by the written subcontract.

turbine spiral cases, it thereby also agreed to furnish a standby operator.

The arbitrators are merely saying that Appellant during the course of negotiations made an offer to furnish a standby operator, that the offer was made for the purpose of securing the subcontract, and that, therefore, Appellant should be bound by the offer. There is nothing ambiguous about paragraph 8 of the Arbitration Award, in or out of context; therefore, it is unreasonable and implausible for the Court to conclude that the Board had found the furnishing of a standby operator in connection with prestressing of the spiral cases during embedment to be one of the duties assumed by Appellant in agreeing to install the spiral cases under paragraph 1 (b) or any other provision of the written subcontract.

B. Misuse of Parol Evidence Is Not Merely Error in Interpretation of Law or Erroneous Finding of Fact.

Appellees' argue in their Answering Brief (p. 20) that even if the arbitrators violated the parol evidence rule, such violation is not a ground for vacation of the Arbitration Award. For purposes of this discussion, Appellant will concede that as a general proposition, an Arbitration Award will not be set aside for mere errors of law.

Be that as it may, the Federal Arbitration Act, 9 U.S.C. Section 10 (d) clearly gives to Appellant the right to have the Award set aside if in making it, the arbitrators have exceeded their powers. In the instant case, the violation of the parol evidence rule involves the arbitrators in exceeding their powers under the terms of the dispute submitted to them for decision. The arbitrators were asked to decide whether the subcontract agreement between the parties required the Appellant to perform the prestressing of the spiral cases as described in Bid Item 79 and Section 208 (g)

of the Completion Contract Specifications. They were not asked to decide the question of whether Appellants were liable for this work by reason of an oral offer made by Appellant during the course of negotiations in an effort to secure, or clinch, the subcontract.*

The existence of the oral offer came into evidence after the arbitrators had decided that they could reserve making any decision on the issue of whether the written subcontract was clear and unambiguous in its terms, as contended by Appellant, and take further evidence on the parol circumstances surrounding the subcontract (see general discussion Transcript of Arbitration Proceedings, pp. 12-27, and lines 4-9, p. 27). Thereafter, Appellees conducted extensive cross-examination of Appellant's witness concerning events and communications leading up to the award and execution of the subcontract in an effort to establish that prestressing was a part thereof. (Transcript of Arbitration Proceedings, pp. 27-72). Accordingly, on re-direct, Appellant's sales manager testified that, as an inducement to an award of the subcontract, he had in fact orally offered to furnish a stand-by operator in connection with the prestressing to Mr. Louis Bruni, the officer of Appellant, Ets-Hokin, who finally awarded the subcontract (Transcript of Arbitration Proceedings, pp. 82-86, lines 2 thru 17) and Mr. Bruni said nothing to the sales manager to indicate to the latter that he was accepting the offer, or making it a part of the subcontract agreement (Transcript of Arbitration Proceedings, p. 84, lines 18-26). Negotiations continued subsequent to the offer and the subcontract price underwent several revi-

*Appellees recognized this limitation upon the arbitrators when, at the Arbitration Hearing, they argued in favor of parol evidence on the ground that it was necessary to explain certain provisions of the subcontract agreement. (Transcript of Arbitration Proceedings P. 16-17).

sions from a price of \$625,000.00 to a price of \$592,000.00. It was this oral offer that the arbitrators deemed binding upon the Appellant. Paragraph No. 8 of the award refers specifically to this oral offer and not to any term or provision of the subcontract, nor does it draw its conclusion as a necessary implication from the written agreement.

By itself, the oral offer did not constitute an offer to perform the prestressing work. Contrary to Appellees' characterization on Page 17 of their Brief, there is more labor and expense to the prestressing work described in Section 208 (g) of the Completion Contract Specifications than the furnishing of a standby operator. Admittedly, the cost of a "standby operator", constituted the bulk of the cost of prestressing, but someone had to furnish the pump, the pipes, the valves and the gauges, and install and dismantle them. As the Arbitration Award itself recognized, certain costs backcharged by Ets-Hokin did not relate to the furnishing of a "standby operator" (e. g., Transcript of Record, p. 127, Item 17).

Additionally, as a description of the prestressing work demonstrates, (Paragraph 208 (g), Specifications, Exhibit B to Transcript of Arbitration Proceedings), it was inseparable from the cooling function which Appellee Ets-Hokin attempted to delegate *ex post contracto* to its concrete subcontractor (see Exhibits 26, 27, 28, 29 and Transcript of Arbitration Proceedings, p. 214, p. 212, line 25 to page 220, line 3), and this fact was recognized by the Arbitrators in making their award.* Accordingly, it is oversimplification to characterize prestressing as merely the furnishing of a "standby operator"; and this fact contributes to the isola-

*The Award splits the cost of the standby operator between Ets-Hokin and Chicago Bridge & Iron on the grounds that the standby operator was as necessary for the "cooling" as he was for the prestressing.

tion of the oral offer of a standby operator from the subcontract agreement itself, and the claim that the arbitrators found that prestressing was an implied covenant of the contract.

C. The Lower Court's Use of the Concepts of "Intent and Understanding" Serves Only to Confuse the Issue of Whether the Arbitrators Exceeded Their Powers.

The Lower Court in its opinion reasoned that the issues submitted to arbitration had been expanded by the Appellant when the latter argued to the Board the "intent and understanding" of the parties to the subcontract (Transcript of Record, p. 136, lines 1-18).

It was, and is, the intent and understanding of the parties as expressed and found in their written subcontract agreement which was at issue in this arbitration. The writing is supposed to express the agreement of the parties, to articulate the intent and understanding of the parties. Thus, it is normal for a person to speak of the written document in terms of the "intent and understanding" of the parties thereto as expressed therein.

The Arbitrators were thus asked: Was it the intent and understanding of the parties as expressed in the written subcontract that the Appellant perform the prestressing work required by the general contract? The Lower Court appears to be saying that by discussing the written subcontract in terms of its intent and understanding, the Appellant has expanded the scope of the arbitration to include the intent and understanding of the parties not only as expressed in or necessarily implied from the written subcontract, but their intent and understanding separate and apart from the subcontract agreement as it might be revealed by the events and communications prior to the execution of the

subcontract. This simply is just not so. At no time did the Appellant ask the arbitrators to ignore the written subcontract and make their own determination of the parties obligation over and above what can be drawn from the written agreement itself, either expressly or by necessary implication. Yes, this is what the Lower Court seems to imply:

“Thus, both plaintiff and defendant included and understood to be included among the issues to be discussed and determined by the arbitrators the intention and understanding of the parties, which clearly goes beyond the question of the inclusion or not of a specific written covenant in the subcontract.”

(*Transcript of Record*) p. 136, lines 19-24).

If all the Lower Court means to say is that the parties intended for the arbitrators to construe or interpret the written subcontract, then Appellant has no argument with the Court, and would disagree with the Court only on the question of whether, in finding Appellant obligated to furnish a “standby operator”, the arbitrators were construing or interpreting the written agreement. But, since the arbitrators obviously and unequivocally ignored the written agreement in rendering their decision that the Appellant should be bound to furnish a “standby operator”, it is not reasonable for the Court to conclude that the arbitrators were construing or interpreting the written agreement.

Accordingly, the Court must be saying that the Appellant agreed to expand the issues beyond the “intent and understanding” of the parties as expressed in the written agreement to include an “intent and understanding” not based upon the written agreement, either expressly or by necessary implication, but upon events or circumstances occurring or existing prior to or contemporaneous with the execution of the agreement. Appellant agreed to no such thing, and, in this, claims the Court below to be in error.

D. The Parol Evidence Rule Demonstrates the Manner in Which the Arbitrators Exceeded Their Powers.

While Appellees deem the parol evidence rule to be a mere rule of law, for the violation of which, the Arbitration Award cannot be set aside, Appellant believes that its violation in this instance serves to point up the manner in which the arbitrators have exceeded their powers under 9 U.S.C. Section 10 (b).

To begin with, the rule has been well established that:

“Neither a court of law nor a court of equity can interpolate in a contract what the contract does not contain, either in words or by necessary implication.”

17 Am Jur 2d *Contracts*, Section 242, p. 629.

As demonstrated in the Opening Brief, the subcontract of August 22, 1962 was intended by the parties to set forth their entire agreement and transaction.

“Generally speaking, where the parties to a contract intend a writing to be the sole memorial or integration of the contract, the writing embodies the contract and accordingly, the construction of the contract consists of the construction of the writing. . . .”

“As a rule, all prior negotiations become embodied in the writing when both parties enter and sign a written contract. Thus, in the absence of mistake or fraud, a written contract merges all prior and contemporaneous negotiations in reference to the same subject and the whole engagement of the parties and the extent and manner of their undertaking are embraced in their writing. The written agreement, and not the correspondence which preceded it, is the correct exponent of the contract, and all verbal agreements made at or before are to be considered as merged in the written instrument.”

17 Am Jur 2d *Contracts*, Section 260, pp. 662, 663.

“. . . parol evidence is inadmissible to vary or contradict the terms of a valid, and plain and unambiguous

written contract, no preliminary negotiations, and no parol agreement prior to or contemporaneous with, a written contract, which tends to vary or contradict either its express provisions or its legal import, can be considered in construing it. . . . *Parol understandings, although they induce the making of a written contract are merged in the writing so that they cannot be used to change the contract or show any intent different from that expressed in the instrument.*" (Emphasis added)

17 Am Jur 2d *Contracts*, Section 261, pp. 664, 665.

Thus, Appellant's position throughout the arbitration hearing that the Board construe the subcontract from within its four corners and resort to extrinsic evidence only in the event it deems the subcontract unclear or ambiguous, is consistent with Appellant's contention that the issue of prestressing involved only the intent and understanding of the parties as expressed in the subcontract; and further, that in the event extrinsic evidence should be considered by the Board, it be done so only for the purpose of construing or interpreting the writing.* A reading of paragraph 8 of the Arbitration Award clearly shows that the Board did not consider the evidence of the prior oral offer to furnish a "standby operator" for the purpose of construing any provision of the subcontract or making any determination that

*In their Answering Brief (p. 20), Appellees argue that Appellant conceded to the Board that it could ignore the parol evidence rule, and presumably therefore consented to an expansion of the issues. Appellant's statements on page 15 of the Transcript of Arbitration Proceedings were not made with a view to expanding the issues, but in recognition of the fact that the arbitrators might not follow the guidelines of the rule and devise their own method for construing the written agreement. It was recognized that arbitrators are not bound to follow the technical rules of law and that they could utilize their own notions of justice in resolving the dispute; but, the dispute was not thereby expanded. It remained the same: namely, did the agreement of the parties as represented by the written subcontract require Chicago Bridge & Iron Company to do the prestressing?

prestressing was by implication from the terms, conditions and subject matter of the subcontract, a necessary part thereof. Paragraph 8 of the Award unequivocally states the proposition that the Appellant, having made the oral offer as an inducement to its grant, should be bound by the offer. One must assume at this point that the arbitrators must have found either an oral acceptance of the oral offer, (although the Hearing Record is devoid of such evidence) or a moral obligation to carry out the offer. In either case, the arbitrators are clearly making their Award on the basis of an issue not submitted to them for decision, i.e., whether Appellant should be obligated to perform the prestressing because of a prior oral offer made as inducement to secure the subcontract. Had that issue been within the scope of the submission, the Arbitrators would not have been exceeding their powers. As it was, that issue was not within the scope of Appellant's cause of action in the Arizona District Court, nor the Appellee's Demand for Arbitration, the Arizona District Court's Order staying the Court proceedings and the subsequent proceedings in arbitration. It was the Board's failure to stay within the limits prescribed by the parol evidence rule, of which it was fully advised, that led it astray and caused it to exceed its powers.

While Appellant does not subscribe to Appellees' criterion for determining when arbitrators exceed their powers, i.e., whether the arbitrators could reasonably believe that the binding effect of the prior oral offer was an issue for them to decide (see page 20, Answering Brief), nevertheless, it was Appellant's explicit explanations of the parol evidence rule which made it unreasonable for the arbitrators to believe that they were called upon to enforce an agreement or moral obligation, other than the written subcontract agreement.

FAILURE OF APPELLANT TO PROTEST ARBITRATION TO ARBITRATORS DOES NOT WAIVE RIGHT OF APPELLANT TO PROTEST AWARD OF ARBITRATORS UPON STATUTORY GROUNDS.

On Page 12 of the Answering Brief, Appellees argue that because, subsequent to the Arizona District Court's Stay Order, Appellant proceeded to arbitrate without protest to the Arbitration Board and made no objections to the effect that the arbitrators were considering questions beyond the scope of the Stay Order, that they cannot now be heard to complain of an unfavorable Arbitration Award and allowed an opportunity to take another bite at the apple. Appellees cite *American Almond Products Co. v. Consolidated Pecan Sales Co.* 144 F.2d 448, 450 (2d Cir. 1944) in support of this proposition.

First, it should be noted that Appellant did protest the Arbitration in the most effective forum available to it at the time, the Arizona District Court. Appellant objected to arbitration primarily on the grounds that arbitrators would not adequately protect Appellants' Miller Act rights under its subcontract agreement; that questions of law and the interpretation of the legal obligations of the parties under a written subcontract agreement were at issue and that arbitration was not the proper means by which these rights and duties could be determined. Appellant was unable to convince the District Court Judge that its Miller Act rights would be prejudiced by the arbitration.

At that point, Appellant either had to proceed with arbitration, or appeal to this Court the Stay Order of the District Court. The decision was made to proceed with the arbitration in the hope that it would have a happy ending; but that if it did not, and the reasons therefor were the very reasons advanced by Appellant in support of its objections

to the Stay Order, it would be easier to demonstrate to an Appeal Court the prejudicial effects of arbitration upon Appellants' legal rights in the context of the rationale provided by the Supreme Court in *Wilko v. Swan*, 346 US 427 (1954) for its refusal to permit a party's legal rights under the Federal Securities Act of 1933 to be determined by arbitration.

Secondly, Appellants had no reason for anticipating in advance the fact that the arbitrators would base an allowance of the prestressing backcharges on an oral offer to provide a standby operator made during the course of contract negotiations.

Thirdly, the *American Almond Case*, Supra is not analogous to the facts at hand. In that case, a party against whom the arbitrators had assessed damages, objected to the Award on the ground that damages were not submitted to the arbitrators for decision and that in fixing the damages the arbitrators had considered evidence not in the record. (The record was actually devoid of evidence on the amount of damages, except for a statement of counsel as to market price). This, it was contended, constituted misbehavior by the arbitrators under 9 U.S.C. Section 10(c). It was conceded that the prevailing party's statement of issues contained a claim for damages. The complaining party being so advised, the Court found that the complainant was bound "in good faith either to protest that the prevailing party had misapprehended the scope of the submission, or to ask leave to put in evidence of market value."

"The one course not open was to allow the arbitration to proceed to an award upon an assumption which (1) was naturally to be drawn from the submission itself, which (2) the plaintiff had plainly adopted, and which (3), so far as appears, demanded nothing of the arbitrators which they were not competent to provide."

American Almond Case, Supra, p. 450.

Thus, while the *Almond* case does appear to impose a duty upon a party to an arbitration to protest an issue not agreed to by the party as an issue to be arbitrated, it was clear in that case that the claim for damages was a clean cut issue before the arbitrators. One of the parties had asked the arbitrators to make an award of damages. In the instant case, as can be seen from the Lower Court's attempt to include the oral offer as an issue in the arbitration, the issue was neither clean cut nor conceded by Appellant to be an issue in the arbitration. Indeed, Appellant's first awareness of it as an issue was the award of the arbitrators.

III.

9 U.S.C. 11(a) DOES NOT REQUIRE THAT THE MATERIAL MISCALCULATION REFERRED TO THEREIN APPEAR UPON THE FACE OF THE AWARD.

Appellees argue on page 21 of their Brief that the material miscalculation specified in 9 U.S.C. 11(a) as grounds for modifying or correcting an arbitration must appear upon the face of the Award. The two cases cited in support of this proposition do not appear to Appellant to stand for any such proposition. *James Richardson & Sons, Ltd. v. W. E. Hedger Transportation Corp.* 98 F.2d 55, 57 (2d Cir. 1938) involved a complaint on appeal to the effect that the arbitrators had failed to assess any damages for a carrier's delay in freighting wheat, although the arbitrators found delay and the freighting contract provided for damages for delay at a specified daily rate per ton. The Court said it would not amend the award or overrule the arbitrators on this point, because to do so would constitute disagreement as to matters of law or facts determined by the arbitrators.

In *San Martine Compania de Navegacion, S. A. v. Saguenay Terminals*, 293 F.2d 796 (9th Cir. 1961), the Court, hav-

